ized on an office level throughout the nation, but after the 4600 accounts, which make up the base that pays 65 percent of the tax, to this priority group of accounts we've gone back to various publications which list the larger taxpayers in the nation. We've used lists such as Fortunate [sic] 500, the Texas business—top 400 businesses in Texas. We've looked at the lists put out by (p. 272) *Inc. Magazine*, and we have increased our priority group to the larger taxpayers who may not be paying a lot of tax to the State of Texas but have the potential to pay a tax to us, and we have included those as priority accounts and upped the grouping to around 56 to 5700 accounts.

Q. Okay, sir, and these are audits of persons that are already permitted; is that correct?

A. That's correct.

Q. And do you have any jurisdiction over persons that are not permitted?

A. If I could go back and clarify one point?

Q. Sure.

A. Some of the accounts that we look at within the Fortune 500 group or the—the Texas 400 would be—pardon me—may be permitted for sales tax or may not, depending on what they do, and some of the Fortune 500 companies fall in that same line. Most of these accounts do hold a Texas sales tax permit.

Q. Okay, sir, and if you find a situation—let's say, you're going through an audit—a taxpayer's records and you find (p. 273) records of a vendor—that somebody

had sold that taxpayer something that's an out of state name, what would you do with that name?

A. If we see the seller has not collected the tax, we could go back to our computer system, run his name, find out if he does hold a Texas permit. If he does not hold a Texas permit, we'll try to establish in the audit whether or not the seller called upon the purchaser with a salesman, whether the purchaser found out about the item he was buying through a publication catalog or whatever. We would look at some shipping documents to see where the item that the purchaser was buying—where it was shipped from to see if the seller had inventory in Texas or if it came from a third party source or it came from an out of state location. We would do this—we rely very much on our audit staff for leads in this area because of the amount of sales in the State of Texas. From there if we can see that there may be a good case for us to say that this company is doing business in the State of Texas, we will then go and try to audit this company and assess tax against all of the other sales we've made in the (p. 274) State of Texas. On that particular sale that we've looked at, we will assess it against the purchaser.

Q. Okay, sir. Now, does the Comptroller's Audit Division have a method of scoring accounts to decide whether or not they might have a high incidence of non-compliance?

A. Yes, we have one of the few scoring systems in the nation to score accounts. It's a regression formula—not qualified statistically to speak total about it, but it takes into account various factors and scores the accounts with the highest probability where we can assess tax.

Q. Okay, sir, and this again is the accounts that are permitted; right?

A. Yes, sir.

Q. Okay. Now, if you—do you receive leads from the Enforcement Division, with respect to accounts that might need auditing or that have been just set up for business and that might need auditing as to prior business?

A. Yes, sir, we receive some leads from our Enforcement Division. They are out and about working on various accounts. They may (p. 275) touch ten to 15 or 20 accounts in a day, and they account for some of our leads, and our auditors—they also account for many of our leads. We may come across a Texas based company as we're auditing someone where we can—where we question why the tax was charged or was not charged.

Q. Okay, sir, and do you check or cross check your auditing records against the records of any other agencies or publications to determine whether or not there might be other people out there that need audited?

A. We use various lists that are provided to us. We use FAA records to find out people who have purchased aircraft. The main thing we're looking there are people purchasing aircraft from out of state sellers so that we can go against them for the use tax. We look at our risks, information. We have data tapes that we are comparing to the files we have in Austin to see if we can come up with unpermitted businesses. We have used Dodge reports, which give us indications of building that's going on in Texas, who is doing the building, what contractor, what company it's being built for. (p. 276) We also moni-

tor trade magazines and publications to watch for people coming into Texas building so that we can assess one sales tax against them on any purchases they make and also to hold them liable for corporate franchise tax, if they are incorporated.

MR. MENDEZ: If I may, Your Honor, before I ask the next question, we had requested that our other witness come over here right now in anticipation of putting him on, but we received notice through Mr. Anderson that he is on his way to the American-Statesman for Mr. Bullock to do some announcement, and so he can't be with us this afternoon. Is there any way we could, after this witness then, continue until in the morning to put him on?

M. GEORGE: What is he going to testify to? Maybe I can stipulate to it.

MR. MENDEZ: Well, he's going to testify as to the amount of money that was set up in the—that was estimated to be generated by the 1984 tax bill and as to what his estimate was with respect to the repeal of the magazine subscription law.

(p. 277) MR. GEORGE: We have that in his deposition.

MR. MENDEZ: I haven't—well, that was your questioning of him, and I'll look through there and see what's available—

THE COURT: —who questioned him. If it's evidence, you can offer it.

MR. MENDEZ: Well, we'd have to look through it. If my co-counsel might go through that deposition, it might be possible to use Mr. George's testimony.

MR. GEORGE: The exhibit that is in his deposition that says what he thought will be collected I'll stipulate is admissible without reading anything or having any witness or anything else.

MR. MENDEZ: Well, I don't know if you asked the right questions, Mr. George, is what I'm asking but I'm going to have—

THE COURT: Counsel, you look it over, and maybe you get it in that way, or you don't get it at all. Now—

MR. MENDEZ: Okay. I appreciate it, Your Honor. We haven't (p. 278) subpoenaed him. So he's—okay.

QUESTIONS BY MR. MENDEZ:

Q. Mr. Lee, I notice from your discussion of these programs that you concentrated on businesses. Could you tell the Court why you're looking at those accounts when you cross check them with these other lists?

A. Well, the main drive of the Audit Division is to maximize the revenue into the State of Texas, and all of the things that we do in our audit select program is to bring in additional dollars with the resources that are provided to us. We have a budget of 29 million dollars out of our agency appropriation from the Legislature, and we're trying—we try to bring in the most revenue with the resources that are provided to us as we can.

Q. Okay, sir. If you—would you need additional auditors—let's say, that hypothetically there's you know, another—let's say, there were five million households in the State of Texas that all of a sudden got permits for remitting their use taxes and that you were required to

develop an audit program to check for compliance. Do you think that you (p. 279) might have to add more auditors in order to audit five million new accounts?

A. I believe the best way to explain is that this year or last year we will do somewhere around 12,000 or 13,000 sales tax audits, which is our portion of the total audits we will do in the fiscal year. There are in excess of 450,000 permitted sales tax taxpayers in Texas. We're doing about two percent of those people right now with 525 auditors. To get a hundred percent compliance of just the permitted people, we can do about ten percent on a four-year cycle now at two, two and a half percent a year. So you can from that, you know, cover just the 450,000-plus sales taxpayers. Then if you add the entire population of Texas, you can think about how many people we would have to have.

Q. Okay, sir. So in your opinion it would be a rather awkward task for your division to add in these types—this many auditors?

A. It would be an awkward task to have that many auditors and a losing money proposition on top of it.

Q. What is your budget on a yearly basis again?

(p. 280) A. Just in excess of 29 million dollars. It costs us about $50,000 a year per auditor.

Q. Okay, and do you have an idea—when you send an auditor out and you know he's going to spend an hour at a specific location, do you have an idea or an expectation as to how much money that person is going to generate from being at that location?

A. We have average—we maintain an average dollar figure that we recoup each year that runs somewhere in the range of $400 an hour, or it has in the last couple of years. The auditor may recoup $10, or he may recoup a thousand dollars. If he sees that he's recouping $10, he is behooved to move on to other areas.

Q. Okay, sir. Now, do you hire trained accountants or persons with degrees?

A. Our personnel are recruited from the colleges and universities in Texas and around the metropolitan areas where we have out of state offices. These people are required to have a degree in accounting, and from there we hire them and take them through our own training courses.

(p. 281) Q. Okay, sir, and about how long would it be before an auditor was out on his own and doing his own audits in the Comptroller's office?

A. An auditor would be out doing his own audits within six months from the date he's hired. He will not be the most productive person we have on board because through our—within our training porgram during the first six months they will receive four weeks of classroom type training and then work on smaller accounts during that first six months. After that first six months, they will continue to work on smaller accounts and get experience. Then progressively receive larger accounts as they receive—obtain more experience and additional training.

Q. Okay, sir, and are publishers of magazines that have permits part of the group of companies that you've audited or are auditing under the programs that you have in place now?

A. Yes, sir.

Q. Okay, and could you give the Court an idea of how many audits of people in the SIC code that belong to publishers have been audited in the recent—well, let's say, in the last (p. 282) five years?

A. I looked at some figures from 1982 forward, and taking the entire group of people that fall under printers, publishers and the like, there have been 1200 audits completed, and there's about 200 audits currently in the inventory. I broke the list down to publishers of periodicals, books and one other group I can't remember, and there has been in the last four years approximately a hundred and ninety audits completed, and there's 40 of those in inventory right now.

Q. Okay, sir, and has *Texas Monthly* been audited for its sales tax?

A. Yes, *Texas Monthly* has been audited.

Q. Okay, and have you received—

MR. MENDEZ: Well, let's do this first: I'm going to have this document marked as Defendants' Exhibit No. 17.

(At this time an instrument was marked as Defendants' Exhibit No. 17 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. Sir, I hand you what has been marked as Defendants' Exhibit No. 17. Is that an (p. 283) interoffice memo that is part of the records of your Audit Division?

A. It's an interoffice memo from our agency. Where in our records, I—it was through one of our previous audit managers.

Q. And is that the type of—well, who was it written by, and who was it written to?

A. It was written by Tom Headner, attorney for field operations, [to] [sic] Jerry Layman, manager of out of state audit group.

Q. Okay, and is out of state audit one of the sections of the Audit Division?

A. It was in a different format but it was in—when this memo was written, but it is part of our program, separately budgeted and accounted for.

Q. To put it in perspective, what's the date of the memo?

A. January 5th, 1977.

Q. Okay, sir, and were you in the Audit Division in 1977?

A. I was in the Audit Division in 1977. Part of the year I was in auditor training, and the latter part of the year I was the manager of our Austin audit office.

(p. 284) Q. Okay, and in the course of being in training, would you have been apprised of these type of policy matters that are discussed in this document?

A. I was generally apprised of policy matters. I don't remember this one right offhand.

Q. Would it have been the type of document that would have crossed your desk in training?

A. Possibly.

Q. You're not real familiar with that document; right?

A. No.

MR. MENDEZ: Okay. Well, I'm not going to introduce it. I didn't know if he knew about it or not.

QUESTIONS BY MR. MENDEZ:

Q. Now, sir, have you received any instruction from your superiors? Well, who is the head of your—who is the Deputy Comptroller in charge of field operations?

A. The Deputy Comptroller for Audit Division is Dan Pearson.

Q. And have you received any (p. 285) instruction from Mr. Pearson as to the treatment of out of state magazine publishers with respect to the sales and use tax?

A. We're not going to treat them any differently than we do any other business selling into Texas.

Q. Okay, sir. So you haven't received any specific instruction to eliminate them from the base or include them in the base in a certain manner?

A. No, sir, there's permitted publishers on our index.

Q. Okay, sir, and now if you were doing an audit of some other taxpayer and you ran across a situation where they had bought a magazine from an out of state company, would that be—would that vendor be checked out—that out of state vendor be checked out for a permit for doing business in Texas?

A. We would assess a tax against the purchaser, and we can check to see if the magazine distributor is doing—is showing any reported taxable sales in Texas.

Q. Is it the policy of the—well, does the Audit Division regularly do audits of (p. 286) religious groups?

A. Not really, no.

Q. Okay. Would you know—well, no. Is the sales and use tax audited on a transaction by transaction basis?

A. It can get to a transaction by transaction basis, yes. We'll sometimes have to do a lot of sampling because of sheer volumes of records, but it goes back down to a purchase or a sale.

Q. Okay, sir, and is a tax assessed on that basis—on the basis of there being purchases and sales that were not otherwise exempt?

A. Yes.

Q. Okay, and the deficiency is always made on that basis; is that correct?

A. Yes.

Q. Okay. Now, have you ever run across the situation where you're auditing a taxpayer, and it turns out he's a purchaser—he's a vendor of goods, and he's delivered goods to a purchaser and then later invoiced them, and when he delivers the invoice, the purchaser strikes out the tax and doesn't deliver the tax with his (p. 287) check back to the vendor?

A. Yes, sir, that does happen.

Q. Okay, and what do you do in a situation like that?

A. Assess the tax against the seller, if that's who we're auditing.

Q. Okay, and is it your business as to whether he goes out there and ultimately sues that person for the sales tax that's owed, or do you care about that?

A. Taxpayers have tried to make it our business but it is not, and we have to explain that to them.

Q. Okay. So if you find a transaction which has not been taxed on the records of a vendor, then you assess a tax against them at that point?

A. That's correct.

Q. Okay, and if he can show you an invoice or some receipt that somebody else has paid the tax, then you'll honor that?

A. Yes.

Q. Okay. Now, there has been some testimony about the contract of the Comptroller with the Multi-State Tax Commission. In your (p. 288) role in the Audit Division, do you deal with the Multi-State Tax Commission on a daily basis in monitoring their activities?

A. I don't deal with them on a daily basis. I do deal with them. I've been working on this contract with them in the recent past getting some credit on the amount of money we're going to be paying to them.

Q. Is it your understanding—or what's your understanding of the types of audits that they might be con-

ducting in their audit program for the Comptroller of Public Accounts?

A. It's under a case—the National Bella Hess case which has to do with nexus.

Q. So would they be doing audits of persons who might be doing business in Texas or that might have contact with the State of Texas?

A. Yes.

Q. Okay, and would these be sales and use tax type audits?

A. Yes.

Q. Okay. Now, sir, there is a company that we're referring to as Company X that has an agreement with the MTC to remit taxes. Are you familiar—and it's a publisher of magazines. (p. 289) Are you familiar with that company?

A. I'm familiar with a company that's a publisher of books and maybe magazines, but I know the book portion that has a—

Q. Did the Audit Division or did the Comptroller's office receive monies from X Corporation pursuant to an MTC audit and then this agreement for them to remit sales and use tax?

A. Yes, we did. This is where I'm getting the interest to offset the contract payment.

Q. So you have a contract payment that you've got to make to the MTC to get into their audit program; is that correct?

A. We are already in their audit program. We are making additional payment because this is another program that is to specifically concentrate.

Q. So this is a supplementary program to your regular audit program; is that correct?

A. That's correct.

Q. Okay, but this doesn't mean that you don't have any—well, do you have any nexus type audits going on, or if your auditors run (p. 290) across situations like that, would you tell them, "Well, leave it up to the MTC" or something like that?

A. It would depend on the case. If we feel that we can get in—from the records we've seen or from the information we've obtained about a particular company and we can get in and see the records, we would do it with our Texas or out of state based auditors. If it's strictly a company that we feel is doing mail-order in the State of Texas—catalog type things, we would recommend that it would go with the multi-state work.

Q. Now, are the assessments by the MTC of Texas sales tax—do they go out under your bill? Is it a statement of accounts due—

A. Yes, we send the bill.

Q. And would that be something that they'd then have to take up with you either in the hearings process or in court, assuming that they wanted to dispute the amount of tax MTC—

A. Under this current agreement, I am not exactly sure how that would work.

Q. Okay, sir. Now, sir, you were asked whether or not you'd audited anybody recently (p. 291) for subscription sales of magazines. Is it the policy of the Comptroller to go out and audit, let's say, a special group that just came under a tax the first year after it's—the tax has been in place or they've been eliminated—their exemption has been eliminated?

A. It's not a policy, per se, to go out and immediately jump on a group that falls under the law. It's my understanding that all of the industry that is affected should have been contacted after the legislation. The only thing that we have done is under our random select program, which is part of our audit select program, we did randomly select somewhere around 400 accounts to be audited this year that were affected by the legislation passed in October of 1984—that became effective in October 1984.

MR. MENDEZ: I'll pass the witness.

CROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Very briefly two questions. One, the multi-state contract that you have been talking about hasn't been signed, has it?

(p. 292) A. No, sir. We're working on it right now.

Q. You haven't made the deal? You're working on the contract hoping to get it negotiated with the other states and the Commission?

A. To my understanding, all we need to do is send it back and send our payment.

Q. It just hasn't been finalized?

A. That's correct.

Q. Okay, and the second question is Company X—the audit was not for 1985. It was for the period prior to 1985—prior to October 2nd, 1984, wasn't it?

A. Yes, sir.

Q. So it didn't include any tax on magazine subscription sales?

A. No, sir.

MR. GEORGE: Pass the witness.

REDIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Isn't Company X paying taxes right now?

(p. 293) A. To my understanding, yes.

Q. Okay, and if they've filed returns since October the 4th of 1984, should they have included tax on any subscription sales of magazines?

A. If they have subscription sales, yes, they should.

Q. Okay, and if they are audited for a period subsequent to the last audit, would you expect it to include these receipts?

A. Yes, any publisher we audit we'll assess a tax against.

MR. MENDEZ: Pass the witness.

MR. GEORGE: No questions.

THE COURT: You may step down.

(At this time there was a brief discussion off the record, during which time an instrument was marked as Defendants' Exhibit No. 18 for identification.)

MR. MENDEZ: Your Honor, we're offering Exhibit No.—Defendants' Exhibit No. 18, which is an interoffice memo of the Comptroller's office from Billy Hamilton to (p. 294) Wanda Hutcheson who's testified here, and it involves a revenue estimate of the Comptroller's office that estimates how much money would be lost—would be—how much tax increase would arise from the repeal of the exemption on subscription sales of magazines and during the 1984 Legislative session and covering the years that are on this memo. It affects from 1984 through 1989 and—

MR. GEORGE: The only problem is you're summarizing this—magazines and newspapers grouped together.

MR. MENDEZ: No, it's magazines and newspapers together, and we're offering it under a stipulated—under an agreement with plaintiff's counsel.

MR. GEORGE: No objection.

THE COURT: All right. Admitted.

MR. MENDEZ: And, Your Honor, with respect to the deposition of Billy Hamilton that was taken in this cause, we have a small portion to read.

THE COURT: All right.

MR. MENDEZ:

(p. 295) "Question: Mr. Hamilton"—

MR. GEORGE: Which page?

MR. MENDEZ: Page three.

MR. GEORGE: Page six?

MR. MENDEZ: Three.

Examination by Mr. George:

"Question: Mr. Hamilton, would you state your full name and business address for the record, sir?

"Answer: My name is Billy C. Hamilton. My business address is 111 East 17th, Austin, Texas 78734.

"Question: How are you employed?

"Answer: I am the director of fiscal management for the Comptroller of Public Accounts."

Move on to page four, line 15. Question by Mr. George:

"What is your job responsibility with the Comptroller of Public Accounts?

"Answer: I am director of fiscal management which takes in two operational parts of the Comptroller's office, statewide accounting system and revenue estimating.

"Question: What is your educational (p. 296) background?

"Answer: I have a bachelors degree from The University of Texas at Austin. My major field was government and economics. I have a masters degree from the LBJ School of Public Affairs. It is a masters of public affairs."

Page five, line one.

"Question: When were those degrees awarded?

"Answer: I got my bachelors degree in 1973 and my masters degree in 1975.

"Question: How long have you been employed with the Comptroller's office?

"Answer: Since December 1976. It is going on nine years.

"Question: What jobs have you held during that—the employment?

"Answer: I began as an analyst in the fiscal policy research Section of what was then planning and research. I was later in 1978 made director of research in that same division. I became director of revenue estimating in November of 1982, and I became director of fiscal management in April of 1984.

"Question: How does revenue estimating— (p. 297) what does revenue estimating division do?

"Answer: The Comptroller of Public Accounts has a constitutional requirement that he estimate the revenues available to the State that the Legislature has available for appropriation during the budgeting process. The revenue estimating division—section does economic forecasting and any prediction of revenues that will come into the State over the coming biennium from which the Comptroller makes his revenue estimate."

Going on to page six at line 16. Question by Mr. George:

"Now, do you have the responsibility to determine when proposed legislation—when legislation is being pro-

posed that is in the nature of the tax alteration, either an increase in taxes—increase in the types of transactions being taxed or conversely a decrease in some aspect of the revenue raising, to make an estimate of the impact of that change upon the revenues of the State of Texas?

"Answer: Yes."

Going on to page seven at line one.

(p. 298) "Question: Was that job part of your job responsibility in estimating the effect of tax changes in the summer of 1984?

"Answer: Yes.

"Question: Did you make some sort of estimate of the effect of the change in the tax law to include subscription sales of magazines—what was—what that change would do to the revenue base or revenue of the State of Texas?

"Answer: Not specifically. We made an estimate of what the effect of doing away with the subscriptions to magazines plus newspapers would have an affect [sic]. It was a combined estimate. It wasn't a breakdown between newspapers and magazines."

On to page nine at line six. Question by Mr. George:

"Does the Comptroller's office to your knowledge have an estimate—any estimate at all about what the amount of revenue that is potentially from the sale of magazines to Texans by subscription is?

"Answer: Only in the sense that it's part of the overall estimate for newspapers and magazines.

(p. 299) "Question: Can you tell the jury how you went about making an estimate for both? You made an estimate, as I understand that, for both newspapers and magazines without breaking them out separately; is that correct?

"Answer: That is true, yes.

"[sic] Would you tell the Court and jury how you did that, sir?

"Answer: It is a fairly complicated process. The basic information that we use is a study done every ten years by the U.S. Department of Labor called the Consumer Expenditure Survey that is used to develop the consumer price index forecast that the federal government releases. It contains very detailed"—on to page ten at line one—"information on what individuals spend their money on. We took basic information on payments for subscriptions, which is one part of that, and for spending on newspapers and other periodicals the information from that—we projected it forward to the current day using inflation population growth forecasts.

"Question: As I understand it, from the information produced by Ms. Hutcheson, that you (p. 300) used this Consumer Spending Index—is that what you called it?

"Answer: Consumer Expenditure Survey.

"Question:—Consumer Expenditure Survey for the periods of 1972 and '73?

"Answer: That is right.

"Question: And you based your projections on that by taking—by making an assumption that the increase in

the consumer price index that had occurred generally had occurred in equal amounts to the sale of newspapers and magazines?

"Answer: That is true.

"Question: And then you just arrived at a number based on those two assumptions; is that correct?

"Answer: Yes.

"Question: No one has ever gone out and tried to find out if"—and then on to page 11 here—"there is publicly available information about the amount of commerce that takes place in magazine sales by subscription, is that correct, other than this particular—

"Answer: We did some. The estimate was done in a fairly short amount of time. We did (p. 301) research on available information. This was the best available information as far as we were concerned.

"Question: What other available information did you consider using, if any?

"Answer: We looked at information on sales of magazines in the state by type of magazine. We looked for information on the sales of newspapers and other periodicals in the state by type or by cost, and there is some information like that available, but it is very limited, and it didn't work for our purposes.

"Question: Do you remember what that might have been that you not—that you thought was too limited—that information?

"Answer: No, I don't recall that.

"Question: Now, do you recall how much total increase in revenue that you propose to the State as a result of the imposition of tax upon both the newspaper and magazine sales would be?

"Answer: It was about six million dollars a year for the State."

On to page 12, line one.

"Question: This is for both types of (p. 302) subscriptions?

"Answer: Right. That was for the overall exemption.

"Question: Now, since the legislation has been effective now for 11 months approximately, has anybody gone back and determined as of now what revenue has actually been collected or made any efforts?

"Answer: No, as I say, the fiscal year has just ended four or five days ago. We really don't—won't do that analysis until later in the current fiscal year."

On to page 15 at line one.

"Question by Mr. George—

THE COURT: 15, you say?

MR. MENDEZ: 15, line one.

Question by Mr. George:

"What is the level of dollars that would be significant in the scheme of things for determining the effect of a tax increase?

"Answer: First in this day and time at any tax level is significant, but the ones we will focus on in our analysis first would be aspects that raise, say, 15 million or above in a given year.

(p. 303) "Question: And what changes in the sales tax besides a rate change do you believe would fall within that category?

"Answer: Tax on repair services."

On to page 20 at line 12.

Question by Mr. George:

"One of the things that is involved in determining—is determining what the effect of the tax rate would be if you raised—if you got more money out of any particular tax obviously, and we have an increase in the tax rate generally, did we not?

"Answer: Right, yes.

"[sic] And I assume that the total package of taxes were assumed to raise certain amounts of money?

"Answer: Right.

"Question: Four billion dollars or something over a two-year period; is that correct?

"Answer: It was 1.3 billion dollars in one year."

That concludes the section of the deposition that we wish to introduce.

MR. GEORGE: We have (p. 304) nothing from this deposition.

MR. MENDEZ: We rest.

MR. GEORGE: We close.

THE COURT: All right, gentlemen, then I'm going to let this matter be presented to me. You can argue it tomorrow at 9:30 in the morning.

MR. MENDEZ: Thank you, Your Honor.

MR. GEORGE: Thank you.

(At this time the proceedings were adjourned until 9:00 a.m. on February 5, 1986.)

(p. 1) NO. 378,384

TEXAS MONTHLY, INC.	)	IN THE 345TH
	)	
VS.	)	
	)	
STATE OF TEXAS, BOB	)	
BULLOCK, COMPTROLLER	)	
OF PUBLIC ACCOUNTS OF	)	JUDICIAL
THE STATE OF TEXAS,	)	DISTRICT
JIM MATTOX, ATTORNEY	)	
GENERAL OF THE STATE	)	
OF TEXAS, ANN RICHARDS,	)	TRAVIS
TREASURER OF THE	)	COUNTY,
STATE OF TEXAS	)	TEXAS

STATEMENT OF FACTS
VOLUME THREE

BEFORE THE HONORABLE JOE B. DIBRELL, JR.

APPEARANCES

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(p. 2) BE IT REMEMBERED, that on the 3rd, 4th and 5th days of February, A.D. 1986, the above numbered and entitled cause came on for hearing before the HONORABLE JOE B. DIBRELL, JR.

WHEREUPON the following evidence was given and proceedings were had, to-wit:

(p. 3) MR. GEORGE: Your Honor, let me begin with a—what I think is a simple and responsive part of this case, which is the religious periodical exemption, which I've written up here and—

THE COURT: All right. I've read those cases.

MR. GEORGE: And the cases—I have not—and if I had, I would have found one, and I think if Mr. Mendez had found one, he would have cited it, too—found a case in which we have a Court that dealt exactly with the kind of situation we have here with a clear—and there's no question this is a content—that's what it has to say—based discrimination. All of those are contents. It has to say those words to get the tax exemption. I have found no directly in point case with a tax exemption dealing with this sort of thing, and Mr. Mendez' brief doesn't cite one either, and there aren't any directly in point because I don't think—I think this is a unique statute that I could find. We've gone through all of the State case laws, and I found a few sales tax exemptions for Bibles that have never been (p. 4) challenged, and that's it. We're dealing with—

THE COURT: All right. That's my first question. Maybe you can satisfy me very quickly and go on with the cases you've cited and just this: Except the argument that

this does, in fact, require a content determination, obviously your client is not claiming that in one sense that he is—he's not entitled to an exemption?

MR. GEORGE: No.

THE COURT: See, now, that's my problem there. He's not coming in on the idea that "All of a sudden I asked for an exemption, and they wouldn't let it because they examined my content and said, 'No, it doesn't meet the test' "?

MR. GEORGE: No, sir, the test is—well, mine is—and I haven't tried but I admit mine would not meet the test. I mean, there's no question that we—my content wouldn't meet the test, and there's no doubt about that because it's not—I mean, it's not teaching a religious faith, and there's no question about it.

The question is what do (p. 5) you do when you have a content based governmental regulation based on speech. Now, I believe the answer to that question is really easy because—and the case law supports what I think the rule is. That part I do have cases on. The classic case and just as Marshall wrote in that Mosely case, Mr. Mosely was out there carrying around a picket sign and talking about school student policies. They passed an ordinance that—there's no evidence in the record was directed to one man for picketing that school. They then had—he brought an injunctive action to enforce—to enjoin the enforcement of the ordinance. The Court said, "You have in the ordinance a content based discrimination. The remedy is you can't have—you've got to give everybody the exemption that is in the same circumstances, and the content on

the sign can't be a basis for making decisions. Therefore, everybody gets the exemption that is picketing that has something on the sign."

Now, it didn't deal with the problem of the ordinance's regulations on how far it had to be away or the other parts of the ordinance that don't deal with the speech, (p. 6) and in our case just like in the *Speiser v. Randall* case, the old McCarthy era, it's a tax exemption. The veterans that wouldn't sign the oath that had taken the advocacy of those positions weren't seeking to prevent everybody else from getting the exemption. They were getting—they wanted the tax exemption themselves, and that was a relief granted; that is, they get the exemption, too, because you can't have—decide the rule based upon what people say—simple.

Here we say we don't have those words in our magazine. We don't consist wholly of teachings sacred to a faith. We are entitled if somebody—and there's—the facts in this case are not disputed. Ms. Hutcheson testified that there are periodicals out there that qualify. She knows about them, and she testified that people had called her up, and she knew about it, and part of her job was to know about it, and they were there in the course of her career. So there's no question it's a hypothetical exemption. There are people taking advantage of it according to the record in this case, and Ms. Hutcheson clearly testified to (p. 7) that. Mr. Gerhart testified he had purchased those, and we introduced—so that part we have a real controversy with a real exemption that real people are taking advantage of. We have another person, Texas Monthly, Inc., in that same situation. They are periodicals.

Now, Mr. Mendez' argument in his brief regarding this really says we have the—he breaks it down into two parts. The first argument is the Legislature has broad power, and if you look on page 29, "An equally established principle of constitutional law is inherent in the exercise of the power to tax. The State Legislature is free to select the subject of taxation and to grant exemptions." He relies on the broad Legislative power to manage their tax policy. Now, there is no—I don't dispute that that's a broad power, but that power operates differently—and that's the teaching of the Speiser case—when you have speech based decisions. If we're talking about shoes, we have the tax on sandals and not on oxfords—that the Legislature has virtually unlimited power to do that, if they so choose, but we don't have the same—that's what the (p. 8) First Amendment's rule is. That's part of the same compelling reason—compelling interest argument. They need some compelling reason to do this. Well, the only reason—and nobody has gotten up here and tried to justify it because on its face the only basis for that is the promotion of religion—not good activity but religion, and that is a banned objective of government.

THE COURT: It's supposed to be nuetral. [sic]

MR. GEORGE: You can't do that. Now, I think one of the profound reasons why this exemption operates to make it unlawful to tax periodicals—until the Legislature simply abolishes—they can have a special session, abolish that and this argument goes out of the case, if they so choose, and they had plenty of time to repeal that in the summer of '84 when they repealed the other exemptions on periodicals, but until they do the remedy is periodi-

cals, whatever words they are, get the same treatment as these periodicals. That's the remedy the Court grants. Now, the argument that on its face—and Mr. Mendez really doesn't (p. 9) push but—and suggests is that they have—it's traditional to give tax breaks to religion. Religious churches are exempt from ad valorem taxes and other things. The Walz case, which is the Supreme Court case saying that's not establishment, talks about—and Justice—Chief Justice Berger's opinion goes through it. Well, that's part of a long tradition, and it's a part of a general system of good works—being treated—giving tax breaks to encourage them to kind of—

THE COURT: Can you put it in the category of charities, as well?

MR. GEORGE: Yes, and you look at Section 310, which is the general exemption up here—I think it's 310—religious up at the top of that page on the left-hand side—religious, et cetera, et cetera, and it's lumped in there with charities and the solar energy and other things—athletic competition and other things that the government wants to encourage because of their activity. It's not an exemption all periodicals are subject to tax in this state that consist of words other than this. That's the—and it's (p. 10) simple, and I think the reason there aren't any direct cases in point is it is so simple. No one else has done that to pass a pure speech based exemption. The California people did. I mean, that was clearly—you had to say the right words or not say the right words in that case, or you didn't get it, and that went out, and I don't think any other Legislature has tried. That's one reason there's no such thing. Why they decided when the crisis

tax—sales tax rule back in the '60s the first time, do this, I don't know.

THE COURT: Well, they just said periodicals or publishers should be divided by a religious faith without the other.

MR. GEORGE: That's—my argument would—that would be perfectly fine, if it was part of periodicals published by religious faiths—

THE COURT: Charitable organizations?

MR. GEORGE: —the Boy Scouts and the American Cancer Society and all of those people got the same treatment as churches, that's perfectly okay. They didn't (p. 11) regulate what they said, and it was based upon the good general charitable category, which is what the constitution of the State says under the one I've referred to in my brief and the cases on it. That would be fine, but it would have to have two things. It would have to have more people in the category than these, and it would have to omit this language because it couldn't regulate what they said. You could say—and they might have it for profit or something, but they can't say you get tax preferences because of what you say, and that's simple, it's easy and, I think, disposes of this case.

His argument that the remedies—we have to declare the whole—that we get—all of these people are not exempt anymore—that kind of argument has been dealt with, and there's a wonderful Texas case that is from the old days of railroad taxes and contains exactly the same kind of argument the State made in 1881 involving the Pullman Car Company, and there's a provision in the consti-

tution, Article 1—Article 8, Section 1 says, "All taxes will be fair and equal." Article 8, Section 2 says, "All occupation taxes shall be fair and equal," (p. 12) which deals with taxing lawyers and doctors differently, et cetera, and they had a—and those constitutional provisions are different than the Fourteenth Amendment and have been in the law—different than equal protection. They have been in the law of the state since before it was a state and the Pullman case involving a tax on railroad cars not owned by railroads. There was a tax—the Legislature passed a tax that all railroad cars not owned by railroads had to pay taxes, but if you owned a railroad, you didn't have to pay it. The Supreme Court said, "if you're in the business of having railroad cars, you've got to be treated the same way. Whether you own a railroad or not is not a rational basis for distinction." The Court—and the argument by the Attorney General was, "Well, the remedy is to declare the entire tax system unconstitutional or to simply deny the exemption to the railroads." The Supreme Court said, "No, the Legislature has decided not to tax the railroad company. So we can't tax them. The remedy is not to tax the Pullman Company either who makes—owns cars but no railroads until they tax the railroads. (p. 13) When they do that they can tax everybody the same," and I have a copy of that case and highlighted some of it. That has been followed, and they're not too—these cases are—kind of come in periods of economic crisis in this state or change in this state, and the other classic case involving the same holding that comes to the exact same conclusion is the old chain store taxes passed during—in the—during the depression era, in which they went around and taxed people who had branch

stores differently, and various exemptions from those were under attack under the same Article 8, Section 1 and 2 provisions and they—this is a Dallas Court of Appeals case. It didn't have any history, but it is the classic law in the case following Pullman. It says, "Look, the remedy is when they take out the unlawful exemption, everybody similarly situated will be taxed, but we don't have to declare—the only part of the tax that gets declared unconstitutional or unenforceable or you can't collect the tax are those that are integrally related to this—the unconstitutional provision here, and the only people that would be affected is somebody (p. 14) classified as periodicals." So this is the *Hurt v. Cooper* case. Mr. Mendez cited it and gave you a copy, I believe, but here's another copy.

Now, so in sum I think this is an easy argument. I think it disposes of the case, and the Court needs to go no further, but given the nature of this case, we have the two arguments on the Fourteenth Amendment and under Article 8, Section 1 of the Constitution of Texas are both very related. These arguments essentially are the discrimination of this tax, okay, and as I said when I set out before we started, the tax on its face is nuetral. [sic] We are—there is no special singling out of magazines. They're just treated like everybody else. It's the implementation of the tax that we are complaining about, and that's what all of the evidence has been is that we're talking about how the tax is operated. It does not operate in this—in a fashion to be equal.

Now, this is a case in which the facts need to be reviewed. What has been the testimony? My elements of proof under this provision were unequal tax, unequal ad-

ministration that—intentional. That's not (p. 15) deliberate but intended. They know what they're doing and know that it operates that way. A choice has been made in effect and harm. I had to prove those two facts. Now—or two and a half facts, however you would submit that on a special issue. Probably submit it as three issues. Now, here what is the evidence? Again we have clear testimony from the Comptroller's personnel on the unequal. What do we have? We have two—we claim two kinds of unequality. We claim they—you didn't—out of state people, publishers are not required to collect, one claim, and the next claim is I don't think there's any serious argument. Not a witness testified of anything they've done. They haven't done a thing to go out and collect the tax. Everybody said they knew salesmen were in the state. They knew order takers were school kids. That's no question they knew that. Mr. Gerhart went over and told them that. Their own personal experience—Ms. Hutcheson—people had come to her door. It's a common experience. Everybody—I mean, it's almost judicial knowledge that there are people coming to everybody's door trying to sell them magazines, (p. 16) and they have a whole list of subscriptions. That's—I mean, it's almost judicial knowledge to that fact. Everybody that got on the witness stand knew that that was going on, and there is no question that under the statute and under the cases that some nexus—they say, "Well, nobody says that we don't know about it, and nobody says that we don't—we try to collect it." They say, "Well, there may not be nexus." Their own statute says order takers give nexus. The general counsel, Mr. Anderson, gets on the witness stand, and he says, "I'm familiar with the Scripto case, and I know that independent contractors give them nexus, and I know

that that's what the statute says, but there may be a complication if they are not"—some sort of privity argument. Cases to support that? "There may be some, but I wouldn't take that legal position." That's the position they've taken. "We haven't done anything about it. We know it's happening. We haven't done anything about it." Mr. Castlebury—every witness—Mr. Castlebury, Mr. Harold Lee, the man—the auditor, Mr. Shankle—Glen Shankle, the young fellow that was the enforcement guy—everybody (p. 17) said, "We do this intentionally, and we know it discriminates. We know"—Castlebury, Ms. Hutcheson—all of them said, "We know it discriminates against Texas publishers." Everybody said that. That's the unequal—has been—I don't think there's any question that the preponderance of the evidence has been—

THE COURT: There's been argument that it's because it's uneconomical for them to—

MR. GEORGE: Well, their argument is—there is a second part of our argument is consumers owe a tax. Now, I think their whole argument on uneconomic was to here. I argued this, too, and the Legislature decided to make the—

THE COURT: Well, see, your client argues that also. It's uneconomic for them to try to collect.

MR. GEORGE: That's right, and there is an uneconomic—I think the evidence is they don't know really. They haven't tried.

THE COURT: Well, I think Justice Brennan or somebody said in their—(p. 18) thought that that was some-

thing you could call—take a few minutes from an auditor to know it was uneconomical—

MR. GEORGE: Probably would be uneconomic. We are dealing with a problem of First Amendment protections that is difficult because we—getting to their—Mr. Mendez doesn't really argue that I'm wrong on the facts. When you look at his brief, he doesn't really argue that's not happening. He simply says there's a rational reason. Now, the question is does the rational reason test apply? I think that's the teaching in *Minneapolis Star Tribune v. Minnesota Tax Commissioner* is that the rational reason doesn't apply, but the facts again—they haven't tried. They haven't tried to do it, haven't tested, haven't encouraged voluntary compliance, and one of the things that—the cases under the Fourteenth Amendment need to be read, and those are the cases that he relies on on this unequal—out of the poultry—the chicken company case out of Alabama and the Supreme Court cases that talk about uneconomic are in a context that it doesn't take into account our history of Article 8 of the (p. 19) Constitution of Texas, which is unequal taxation is specifically—I mean, we have an equal protection clause in our constitution. We've gone beyond that. We have a special provision on equal taxes in the Texas Constitution and if the—look at the City of Arlington cases. Look at the history of that litigation, and it has to be on—there was a long and difficult history in this state of trying to tax intangible personal property.

You remember, as I do, that everybody was supposed to render your bank account, your cash, your household furniture. All of those properties were subject to tax in

this state and were until 1974, and when the current Legislature—the people amended the constitution to exempt them all. They hadn't been able to collect them. The cases in Texas, however, are that the tax collector must have a system of trying. It's a voluntary tax system. Nobody has ever said that they have to go out and levy execution on everybody or they have to audit everybody. They have a system of—they have to have a system that tries; that is, a part of their system is collecting from these (p. 20) people, too, and that's the problem is it's not even a part of their system. They could have ads in the paper, encourage voluntary compliance. They could have come in here with—it's been 25 years since 1961 when we had this tax. I believe it was '61 when we first passed the sales tax. Not one shred of economic evidence that they've ever tried at all, ever run any tests, ever done anything. I noticed the other day—this is not in the evidence but you probably—everybody probably would admit it's true. I took my wife down to Laredo on our anniversary, and she wanted to shop over in Mexico, came across, and there's a man from the Comptroller's office collecting a liquor tax.

MR. MENDEZ: Well, I'm going to object to that because he—we're trying to argue about something here that, you know, is a record, and that just brings in stuff that doesn't have anything to do with this case.

MR. GEORGE: And nobody has a system of asking you about anything else.

THE COURT: I'll let you get a little leeway, too. Don't worry about it. This is a bench trial.

(p. 21) MR. MENDEZ: I just feel it's unfair bringing in stuff that doesn't have anything to do with this case,

and it doesn't have anything to do with the testimony presented in this case.

THE COURT: Okay.

MR. GEORGE: There's no system to encourage—to take—they act like it wasn't a part of the law. That's the problem. Now, but when we turn back to number one, no uneconomic argument. Did you hear anybody say we couldn't collect from *Reader's Digest* enough tax to send an order up there to collect it? Was there any evidence to that effect? No. Was there any evidence that would we couldn't send to the publishers of *TV Guide* and Meredith Corporation or some of these others not to collect the tax from them? No. From *Newsweek*. No. From *McCall's* magazine? No. They didn't say that because it would have been ridiculous to say that. They don't have any reason except some argument that there may not be nexus, but they know there's nexus. They know it. There is nexus. It was established conclusively. They have solicitors in Texas. Now, they say, "Well, (p. 22) we have"—"we think we're going to sign an agreement soon," Mr. Lee's testimony is, "with the interstate"—"and we hope to have them audited someday," but that's simply not good enough.

The taxes in question are from October of '82 to now —October of '84 until now. During that period they certainly haven't had any plan. They didn't have an agreement with the multi-state tax. They had a plan not to do it. Mr. Gerhart goes over there and says, "Please, do it. Here are all of these people. I'm competing with them. It's going to hurt me. Please, go ask them to pay their

taxes," and what did they do? Nothing. Two days before Ms. Hutcheson's deposition in this case she sent out a bunch of form letters to those people, and that is it. No justification exists—none. They haven't given any. Now, when we put these two facts—established facts into the context of the First Amendment and Fourteenth Amendment and the Minneapolis Star Tribune case and look at what does that do, Mr. Mendez' argument again is ,"Well, we"—you know, it's "Tax people have lots of discretion. It's a hard life out (p. 23) there to collect taxes, and we've got to have lots of room to make decisions, and we've just decided that we'd be better to put our resources some place else, and we're not going to do it that way because it's just not"—"I don't really know why they're not going to do this, but they're not going to do this because they just don't think it's cost effective, and they'll get around to these people some time when it gets down their list." The enforcement chief, Mr. Shankle up here—"We're going to get around to them." "When? Do you have any plan?" "No, some day." Maybe, you know, manana [tomorrow] defense—sort of do it on manana, [tomorrow] and nothing, nothing, nothing is here on what they're going to do or when they're going to do it or how they're going to do it and no justification for it, and he says, "Well, we've got wide discretion," and cites a bunch of cases that say, well, wide discretion, rational reason, and, you know, I'll have to admit if I was in here with a shoe case—shoes versus sandals or something, the case law is they do have wide discretion in regards under the Fourteenth Amendment at least. I want to point out there's almost none of those (p. 24) cases under the Article 8, Section 1 of the Constitution of Texas. That's not the way this state has treated

them, but this isn't shoes. These are words. This is the press and this—the Supreme Court after many years—I mean, this is not an ancient case—the Minnesota Star Tribune case. They said, "Treat them equally. Treat the press the same as everybody else, and if you don't, different taxation of the press places such a burden on interests protected by the First Amendment that we cannot countenance such treatment unless the State asserts a counterbalancing interest of compelling importance that cannot be achieved without such differential," and they specifically said, "Raising money is not enough." Different treatment of the press has been established. There's no question we've been treated differently. Under the economics of this industry, they can't collect the tax. There's no way to organize their business and stay in business and collect the tax and must pay it essentially as a gross receipts tax. Now, there's no question that particular press or magazines—it works like a gross receipts. (p. 25)Ms. Mizwa comes in here and she says, "I've been trying. I send them notice and calculate the numbers, and 98 percent of the people don't pay me. I can't go collect that tax. It puts me out of business to collect the tax." Particular members of the press—does it discriminate against particular members of the press? *Texas Monthly* versus *Reader's Digest?* Yes, it does. Mr. —you know, Mr. Castlebury says it discriminates. Ms. Hutcheson says it discriminates. Everybody admits it discriminates the way it's operated. Particular press, it does.

Now, we get to what justification for that discrimination, and they don't have any. They say gross receipts is too costly to do something else, and then they cite a case called the Canteen Company case, which is a Supreme

Court of Texas case, and contend that, "Well, we have chosen to be in the business we are in, and it's just tough luck that we can't collect the tax," and that's essentially the tough luck argument, and, one, I want you to read the American Canteen case, which Mr. Mendez has supplied you copies of, and in that case the (p. 26) Supreme Court dealt with the problem of the vending machine industry, and it had candy bars for sale for 25 cents and they were—and the bracketing system in the state didn't allow you to collect the tax below 25 cents in those days. Nothing is 25 cents anymore, but they said that they are in the same position as any retailer who chooses to sell their product under 25 cents because nobody was allowed to collect the tax under 25 cents, just as Stakely for the Court said that the effect and results or a lack upon retailers of the same class engaged in the same type of business. There is no more discrimination against respondents selling items of 24 cents or less than it would be against a retailer selling items between 51 cents and 72 cents where a portion of the tax would have to be paid by the retailer. They said, "They are in the same place as everybody else," and therefore it wasn't unconstitutional. The main issue in this case was what did the statute mean, whether or not there was a tax below 24 cents, and they resolved that in favor of the taxing authorities. I don't believe this case says that but again compelling interest. They know (p. 27) it discriminates. It discriminates against local publishers, and I want to call you finally on this issue: You remember Mr. Shoemate that was up here yesterday—the guy who heads the East Texas office? He got a memo. What did it tell him to do? To go out and find solicitors for national magazines? Which magazines did it tell him to go audit?

Local magazines, and if you'll look on it, it's picked out two on the instructions to go audit, *Texas Monthly* and *Third Coast*—the exact kind of people that discrimination works against.

It seems to me this is an easy case. One, we have a content by discrimination and no real justification for it. They simply say I'm wrong about the remedy. We have discrimination that they admit, and they admit it's intentional. Their only justification is—for not collecting it from these *Reader's Digest* people is some argument—and I don't really understand it—vague argument that nexus is a gray area. Nexus is difficult. Nexus is hard, but it's not—they've got people in the state soliciting orders, and that's clear, and their general (p. 28) counsel knows it, says it, and "We just"—"We haven't done anything about it, and we intend to do it"—Mr. Wade Anderson. He said he intended—that's what he intended to do. So did Mr. Castlebury.

We have what to me is a—I don't think is a critical part of my case but a critical issue for the State of Texas is the Legislature has passed a tax that the taxing authority is ignoring. Now, there may be a good reason not to have this tax because it's hard to work. It doesn't work very well, and it's hard to collect or something, but is it Mr. Bullock's job to simply say, "I'm going to instruct my whole system to ignore it," particularly when it discriminates against people who publish in state magazines in the free speech area when he knows that's what's happening? No, that's not right, and finally does it harm us? It's clear it harms us. Judge, you can see it harms us. We pay the tax. Nobody else pays the tax. If that isn't

harm, I don't know what harm is. Harm—we had a very qualified consultant come in here and calculate what it says does to the value of the corporation. He came up with a (p. 29) specific number, $3,100,000, and is there any evidence from the other side, any analysis of our organization by the other side, any rationale why it doesn't harm us from the other side? No other evidence. So we've got harm proved. I mean, they don't even contest it. The truth of the matter is they don't even come up here and contest it. It seems to me that we proved all of our elements of the case, and it seems to me that we didn't even need to. It's unconstitutional in the first part to begin with. Thank you.

MR. MENDEZ: If I may approach the—

THE COURT: Surely.

MR. MENDEZ: Mr. George cited the wrong page in my brief for the proposition that we're trying to urge on this religious periodicals exemption. Esseatially the argument is on page 30, and it says that "Constitutional provisions and statutes granting exemptions from tax are always strictly construed to the end that such concession will neither be enlarged nor extended beyond the plain meaning of the language employed," and (p. 30) I've cited an old case on that proposition—well, 1971, and then, you know, into texture because there's a very basic constitutional law concept that applies to taxation, and it's pervasive through all taxation. Anytime you pick somebody to treat him differently, then you look at that in a very strict manner. The Court, in construction of those—and I'd urge the Court to go into texture into those areas. You'll find that the

mechanism for judicial review of these is if you can't logically fit everybody into what is a religious faith or into—or their publications into something that promulgates teachings of a faith through common logic, then the exemption faults. It can't be enlarged. You can't bring other people into it, but it doesn't—it can't be—it's void. You're judicially declaring it void, if it's in an unconstitutional manner discriminating between one person and another. I've—the statute does say exactly what Mr. George says. It says—it does say that it would be a document of religious faith that had certain types of writings in them, and if the Comptroller had sought to follow every word of (p. 31) that statute, he probably would have to go read them and figure out which portions were commercial speech, let's say, versus religious speech. He applies it. He applies it in a manner where he tries to avoid entanglement with religion. He doesn't want to go in and try to decide whether some of these—

THE COURT: Well, I'll grant you that it's her testimony that she doesn't want to do so, but that's not the test, though, is it—what the person wants to do?

MR. MENDEZ: Well, she doesn't do it. There was no testimony that any Comptroller employees ever goes in and looks at a document. There were a couple of exhibits introduced through Mr. Harry Gerhart—

THE COURT: I think it's just question on the telephone. I think it came in asking what it was about and what did it say or something—

MR. MENDE: And the testimony, as the Court will remember, was that we're not—you decide for yourself.

If you're an exempt organization under the other religious organizations exemption, then you're free to (p. 32) make your own decision about what you're publishing, and it kind of makes sense because those people get to buy things free. They get to sell tax free and use them tax free in most instances.

THE COURT: Well, the Court—I recognize that, and of course, Counsel, you're stuck with what the Legislature has done here and I'm not—

MR. MENDEZ: And we haven't carried it out, and the testimony is we haven't carried it out the way the Legislature has done. If Your Honor wants to order the Comptroller to go in and check everybody's periodicals and make sure—

THE COURT: No, I'm not going to do that. Obviously I can't do that. In fact, I recognize if that's what it is, it's unconstitutional.

MR. MENDEZ: And then it really gets—I mean, then we don't have any argument. The argument is if this is discriminating against *Texas Monthly,* one remedy: Get rid of that exemption through judicial voiding. You say this is an unconstitutional (p. 33) protection of a specific group from taxation that works to the detriment of Mr. Gerhart's magazine, and that's the remedy. You can't—because if you look at it logically from the other side—

THE COURT: Well, am I—I'm being asked to say that it discriminates is what I'm being asked to say.

MR. MENDEZ: What's the remedy for that statute? Judicial voiding, judicial repeal. If you don't do that,

then what's a periodical? What's a religious faith? If *Texas Monthly* fits in this exemption, if you're going to expand it to include everybody so that they don't have to—if you're going to expand it to include it so that *Texas Monthly* is an exempt organization within 151.312, then what's the—

THE COURT: Well, let me get this straight because I want to know the mechanics of it. It basically is that the plaintiff is asking me to so interpret that provision that it's—the test is set up to determine on content of the writing, and that is prohibited?

(p. 34) MR. MENDEZ: Yes, sir.

THE COURT: And that follows periodicals that have this. So what they're really asking is not that I don't—that I say that all periodicals are taxed but that they come within—they have to come within it because you can't set up an exclusion of periodicals and then say, "Well, but we're going to exclude certain"—

MR. MENDEZ: That's exactly the argument I'm making, Your Honor. We have a sales and use tax scheme that applies to all taxpayers, all citizens of the State of Texas. There is a provision, 151.312, which is one of the exemptions, and what I'm stating under the law—under *Herren v. United States* under the pervasive interpretation of exemption law in taxation this is a favored classification. They're being treated in a favored manner. If you want to correct the statute, it has a severability clause. If one portion is held unconstitutional, then the rest of the act can operate—

THE COURT: I don't think the severability applies to me to start severing (p. 35) up a paragraph, now, does it?

MR. MENDEZ: That should get rid of the whole statute—get rid of that whole exemption, 151.312. Make all religious periodicals—make all publishers of religious periodicals that are religious faith pay taxes, if that's what you want to do, because if you open it up and include *Texas Monthly,* then who's next? Is the *American-Statesman*—they write also. They've got different content. Do they fit in there? Is the *American Law Journal* a religious periodical? Does it talk about sacred teachings of a faith? That's the argument that it doesn't make sense to expand it to include *Texas Monthly.* The only remedy that *Texas Monthly* can seek from this is to have churches and other religious groups—

THE COURT: Of course, a newspaper is not a periodical.

MR. MENDEZ: Well, Your Honor, any magazine—I don't know what a periodical is, and that's not at issue in this case. All I'm saying is that they write also, and is there a rational difference between publishing on a monthly basis versus a weekly (p. 36) basis or a daily basis? I don't know. I just don't know where you stop when you open it to include *Texas Monthly.*

I'll go on, Your Honor.

THE COURT: Go ahead. Excuse me.

MR. MENDEZ: Speech based decisions on a compelling State interest is a test that we urge does not apply in this case. Minneapolis Tribune was one case, and

freedom of speech lawyers like it a lot because it was a tax. There was a tax on the newspapers on their use of ink and paper and—

THE COURT: You're a freedom of speech lawyer, aren't you?

MR. MENDEZ: Your Honor, I have nothing to do with freedom of speech law, but it keeps getting cited, and there's been cases subsequent. I gave you a copy of the North Carolina decision. That's fine. It's already served its purpose. There was a tax put on newspapers in Minnesota that harmed them, and that tax was operating against that one—those six newspapers in Minnesota because they published a lot of words is what it turns out. (p. 37) Compelling State interest is fine. That's a great test for Minnesota for that one fact situation—no applicability here.

We're talking Article 8, Section 1. We're talking First Amendment equal protection. State action in taxes—we deal with the rational basis test. Look at that North Carolina case. Look at the other cases that occurred before the Minneapolis Tribune. This is a one-shot deal, the Minneapolis Tribune, and I don't think it needs any more mention. What we've got is a rational basis test that applies here, and all the Comptroller has to do or the Legislature assuming—I get a feel that sometimes we're going after statutes, and sometimes we're going after the Comptroller's application of the statutes, and I never can get a real feel for the plaintiff's argument in this case, but let's talk about application of statutes. Has the Comptroller unequally administered—that's an as applied argument right there—in an intentional manner the tax—

the use tax collection scheme to *Texas Monthly* versus anyone else that is similarly situated? The one thing we always get past in this (p. 38) analysis, and which is just as important an element here, is that it's got to be similarly situated. These people have to be in the same class. If the Comptroller seeks to make different classes of persons, then he's got to have a reason for doing it. He's got to have a reason for making different classes. If he's going to—if everybody is within the same group of persons, then they'd have to be treated the same. He can't make any excuses. I want to turn to page—

THE COURT: Well, isn't *Reader's Digest* and *Texas Monthly* in the same place?

MR. MENDEZ: I don't know what *Reader's Digest*—there's no evidence. There is not one shred of evidence that *Reader's Digest* has a contract with anybody to be doing business in Texas that says that that—

THE COURT: What about all of these clearinghouses and all—that people are going out soliciting—

MR. MENDEZ: What—what's—I'm sorry. What's the nature of the contract that underlies their being there? I don't know. (p. 39) The only exhibit we have—

THE COURT: Well, what about the Scripto case, though, that even if you have a contract and you're independent and you show there's supposed to be a complete separation, you're still held accountable?

MR. MENDEZ: That's what I'm getting at, Your Honor. I don't know what the relationship of *Reader's Digest*—

THE COURT: The test is not what the relationship is. It's just whether there is a relationship.

MR. MENDEZ: Well, we don't know. I don't know if there is a relationship. They show up on that exhibit, but other than being there, nobody here was qualified to decide whether there was—whether that scout troop that had that—owned that magazine and was selling it in its own right for *Reader's Digest* or whether there was somebody else other than *Reader's Digest*. I don't know. The only exhibit we had about how somebody might come up—

THE COURT: What about our definition here with reference to nexus and as (p. 40) to what contract has to be?

MR. GEORGE: That's 151.107, I believe.

MR. MENDEZ: Subsection B says representation in the State of Texas.

MR. GEORGE: Soliciting orders, it says.

MR. MENDEZ: Well, it constitutes nexus. The person that was soliciting sales in Texas—

THE COURT: Well, wouldn't that be enough at least to prompt the Comptroller or someone to make an inquiry of *Reader's Digest* or you selling—

MR. MENDEZ: I agree with that, I mean, if somebody had time, and that was one of the things is nobody had ever checked out—

THE COURT: Well, that puts them in the same class is what I'm talking about, doesn't it, at least initially to make some investigation?

MR. MENDEZ: There's no evidence that *Reader's*

Digest and *Texas Monthly* are in the same class of persons in this state. The reason—the one shred of evidence, I guess— (p. 41) it might be a mistake—the one shred of evidence that *Reader's Digest* might have a contact with the State of Texas is that its name shows up or may show in one of the *Reader's Digest* or Quality School Plan exhibits that was introduced in this case. There was nobody that was put on the stand to show the relationship between that name on that list and *Reader's Digest*. There was one exhibit on the defense side that we put on where we contacted *Reader's Digest,* and they affirmatively denied that they had any contacts of any sort with the State of Texas. Now, that—

THE COURT: What about Corporation X or Company X?

MR. MENDEZ: They have contacts with the State of Texas. They have entered into an agreement with the State of Texas, and they're paying taxes today. They're in the same class. They're being treated exactly the same way as *Texas Monthly*. That's what my main problem is when we move over here to this page. Sure we've got unequal treatment somewhere, but I don't know who he means—who *Texas Monthly* means by out of state publishers (p. 42) not being required to collect.

THE COURT: The evidence shows what came in. What I'm just trying to—is at least those who have a nexus—or at least the indications are that they have a nexus and therefore—

MR. MENDEZ: Let's get rid of the other group first. There was a little vagueness, I think, in Mr. George's

mind about who this group was that's not being required and why they might not be required. Well, it's not vague. It's the Federal Constitution. Interstate Commerce clause says that if you don't have contacts—if you're out of state and you don't have contacts with the State of Texas, you can't be required to collect use tax for anybody. Well, that's a pretty good reason for not going after that person. There's no evidence as to whether *Reader's Digest* fits above the line there and is protected by commerce clause or not because we haven't gone out and audited them yet. That's fine.

Let's get into this other group. Mr. Wade Anderson testified that it's a difficult area. Nexus is a difficult area. (p. 43) Your Honor probably notices the effort that *Texas Monthly* has gone to to prove up this case and to prove up their position on tax or nontax liability and our defense of the case. Every one of those nexus audits is being done by the MTC or that will be done by the MTC is probably going to generate a lawsuit just like this one—the same types of issues. Is it—it's just a matter of time when the MTC gets an assessment for Texas, and then Texas issues a letter that says, "You owe Texas tax because you've got contacts." Then we're going to be right back in here, and all of those people are going to be treated the same way as *Texas Monthly*. It's part of the audit scheme. It's part of the enforcement plan, and when a few of those people get seized or closed down or whatever the Comptroller can do to them, then hopefully everybody will fit. I don't know what nexus anybody other than *Texas Monthly* has with the State of Texas because that's the only person that testified on its nexus. Well, no I know three other persons that have nexus with the State

of Texas—Southwestern Art, Inc., which publishes the Reaganite—I mean, the magazine (p. 44) for the Reaganites and the yuppies, and we've got *D Magazine* and *Houston City,* which are published by Southwest Media Corporation. They've got nexus with the State of Texas. They collect tax. They've got the same harm—the same presumed harm.

THE COURT: Well, let me get the record straight. I read *Southwest Art,* and I'm not a Reaganite.

MR. MENDEZ: Well, whatever it is. Essentially I was just trying to remember what it was, but the deal is those people are doing business in the State of Texas such as to bring them under the statute. We know about them because they were here. There's a statement there's people out there not paying their taxes that have nexus with the State of Texas. Where were they? Where's the evidence, and you need to show that to show that there's another group of persons out there. They weren't here. There wasn't anybody that could tell us about them.

Mr. Lepere—okay, he mentioned *Architecural Digest,* which is published in—what was it—California. He (p. 45) says that's one of his clients, and he doesn't know if they collect tax or not. I don't know what their contacts are with the State of Texas. Mr. Lepere couldn't explain for us what the contacts of that company were with the State of Texas. I don't know. Maybe *Architectural Digest* has contacts.

Here we go into another class of persons. Consumers owe tax, and they aren't paying their taxes. Judge, if you don't pay your taxes, I, *Texas Monthly,* don't want to

pay my taxes. If you don't drive 55, I don't want to drive 55. Until everybody pays their taxes, I don't want to pay mine. I don't want to be the first one. Not much of a taxing scheme to work with, if that's the constitutional law that applies that you can—you can't enforce a statute that's on the books because the defense is my next door neighbor didn't pay. That's the argument that's being brought up here because this certainly wasn't part of the pleading. The classification that's in the allegation was, "We're being treated differently from out of state publishers because they aren't collecting the tax." When we showed (p. 46) that they were being treated the same—anytime anybody had nexus they had to pay the tax—and that was the testimony from Mr. Shoemate and Mr. Shankle and Mr. Anderson and from Hutcheson and everybody else. If they find them, they're going to make them pay. Then we had to go and find out, well, there's another person. Judge, you aren't paying your taxes, and so you've got to be brought— and until you pay them, I don't want to pay them—another class of persons right here, and that's where all of the argument and that's where we spent yesterday afternoon.

You can take judicial notice of the fact that Mr. Bullock can't collect the taxes from the consumers. That's what the Supreme Court of the United States did. You can prove it up, which is what we decided to do because we wanted to show the absurdity of some of the administrative techniques that were being provided as a hint. "Mr. Bullock, we're going to show you how to do your work. We want you to go after these people because we think you can make money at it—maybe a hundred and thirty-five million, maybe a hundred and forty-five mil-

lion, and we don't know how much (p. 47) it costs. We frankly don't care. We just think that it's your constitutional duty to go out there and pick those people up, and when you've got all of the pennies, come back and get *Texas Monthly.*" No system? That's right. We don't have a system to get those people, other than voluntary compliance and large ticket items, and that's where the money is, and that's how we're going to pick it up.

Wide discretion? I think the case law, if you'll read it, does say that the Comptroller has discretion in carrying out his job. Rational reason? You decide, you know, if you need to increase Mr. Bullock's budget any more to go out and get that extra money and what it's going to do to operations in the State of Texas. Compelling interest doesn't apply. It's rational basis because they're being treated—it's tangible personal property. This is the same thing as *Texas Monthly* magazine, a piece of paper. You can see it, feel it, pick it up and read it, and that's the only treatment. This is taxable. That's taxable. If it's sold, the same difference. There's no reason for compelling State interest. Nobody is censoring (p. 48) anybody from writing. Everybody has got to pay.

THE COURT: Are we giving somebody that claims it's got some religious faith in there an exemption?

MR. MENDEZ: No, that's up to you, Your Honor. If you think that the religious groups shouldn't be treated that way, then put them under the tax just like everybody else. The newspapers are paying it. Magazines are paying it. Everytime we sell a brief, you're probably paying it. I don't know, but that's the argument that they're making. That's my response to that.

Discriminates against local publishers? Well, it makes sense. The first people you want to go after are the people that are here in Texas—I mean, I think. They should be the people that you want to go after. It doesn't make sense to start our enforcement effort in Maine and work our way down. So, sure, Mr. Shankle was right. One of these days when we get everybody in Texas obeying the law, we can turn our efforts to people that are outside the state and have less contacts and probably less sales, but first we've got to everybody (p. 49) lined up here, and we did pick on these people. They're listed in that, and that does make sense. It's part of the whole rational basis approach.

I don't think, when you get down to it, that there's any reason for giving *Texas Monthly* back its money because everybody else that's in the same shoes is paying it or will pay it, and we'll get them. The argument that I don't want to pay because you aren't paying is not an argument. I don't want to drive 55 until everybody else does is not an argument or is a defense in driving—in a driving violation. In a tax case—and the case law is clear on that—the fact that some other person doesn't pay or that they're in a different class is not a reason for not paying your taxes, and for those reasons, Your Honor, we think that the Comptroller validly imposed taxes upon *Texas Monthly* or required it to collect them.

MR. GEORGE: Very briefly. Your Honor, religious argument—my argument turns back to remedy. What should you do about it? In the Pullman case in the Supreme Court of the United States and every other court that (p. 50) I've ever been aware of that—what you do about it is they say—the Courts say, "Look, tax official,

I can't make anybody pay taxes. I'm a judge. My job is to say you can't enforce the statute as written against people equally situated. I can say you can't collect the taxes from Mr. Jones because you've said Mr. Smith doesn't have to pay. I can't make Mr. Smith pay the taxes. That's the Legislature's job. When the Legislature says, 'Mr. Smith, pay the taxes,' everybody will be square. Until then Mr. Jones doesn't have to pay his taxes." That's the only remedy Courts can give. They can't go out and write statutes. They can't make people pay taxes. That's what needs to be done here. The question of who's a periodical? Who is similarly situated? We know periodicals are similarly situated. There are lots of—there may be lots of questions. Lawsuits may prevail in this, and the Supreme Court affirms it, and we go down the road about who's a periodical, if the Legislature keeps this on the books for the rest of the time. What they choose to do, who knows, and what happens in other cases, who knows. We are a periodical. We proved that, (p. 51) and we proved—and it's no question this is unconstitutional—the remedy is we don't have to pay taxes as long as this is on the books. When it goes off the books, we're back to square one. That's easy.

Briefly his argument about similarly situated. Who testified about soliciting orders in the state? Mr. Lepere said, "I'm familiar with those companies. They solicit orders in this state." "How does it work?" "The order is taken by the guy at the door. The order is sent to *Reader's Digest*, to *Ladies' Home Journal*, which he says he represents." "I know how they do it. They take the order, send it up to the company, and the company sends the

magazine to the subscriber." Mr. Childs said, "That's the way they do it to me. I'm under one of their contracts. Here is a contract. Here is what they do for me." It's in evidence. "They send me orders." The statute says and the Scripto case says, "If you have someone taking orders, it doesn't matter what your contractual relationship with them is, they are in there taking orders," and the rationale for nexus—now, nobody is talking (p. 52) about that. The rationale is that you can't tax people who you don't give any benefit to, and if L. L. Bean doesn't darken the door of the State of Texas and has no—none of the sovereign doesn't give any of the accouterments of being here, they don't use the roads or anything—

THE COURT: They send a mail-order catalog.

MR. GEORGE: —they send a mail-order catalog, you can't tax them. That's the National Bellas Hess case, and the other side is if you have people who are doing things for you using the State of Texas—we've got Girl Scouts and kids and people going door to door. They walked down Mr. Gerhart's street and sold him *Science* magazine, and the purpose was to take an order for that magazine, and the evidence says those orders are taken. They're not sold for resale and then sent to *Science* and *Science* sends the magazine. Those people are getting the benefit of Texas. That's nexus. There's no hard argument. They're similarly situated. Mr. Lepere testified—"How do these companies work?" "Well, they're printed all over the country. They truck their magazines (p. 53) into Texas. They mail them from Texas." "How does *Texas Monthly*?" "It's printed in Nashville, Tennessee. They truck them down here." "How are all these that are printed"—everybody works the same. They solicit ads—

subscriptions the same. They do everything the same. They're similarly situated. That's just—that's not even a real argument.

"Well, we're going to do it some day when we get around to it." That argument—I don't think it's ever worked because the question is when I paid my taxes did you have a system of not doing it? That's what I'm asking for. I'm asking for my taxes back. Mr. Castlebury said, "We knew about it and didn't do it and didn't intend to do it." So did Ms. Wanda Hutcheson. "We didn't intend to do it. We knew about it and and didn't do anything." That's the evidence. We're entitled to a judgment to recover these taxes. That's the judgment we're entitled to. What happens next on this exemption is for some other lawsuit, and you know, if Mr. Bullock and—have a special session, they may take care of it next month, and we won't have to worry about this (p. 54) exemption anymore if the Legislature goes in session, but until they do the Court's job is to decide this lawsuit. Thank you very much.

THE COURT: All right, gentlemen. Thank you for your time and patience with the Court.

MR. MENDEZ: Your Honor, as you know, you're carrying along a plea to the jurisdiction. Do you need any briefing on that or—

THE COURT: On the what?

MR. MENDEZ: A plea to the jurisdiction.

THE COURT: On the Section 8?

MR. MENDEZ: Yeah—no, on paragraph eight of their pleadings.

THE COURT: What was paragraph eight?

MR. MENDEZ: It was their argument that the taxes are gross receipts tax.

THE COURT: Oh, I don't think you're going to have to worry about that part of it, since the way I'm going to rule will take care of it.

(p. 55) MR. MENDEZ: Okay.

THE COURT: Because I'm—frankly, I see no out for the Court but to hold that the provision of 312 is unconstitutional, and I don't think I have to reach a decision on the rest of your—grant relief. That will entitle you to have your taxes.

MR. GEORGE: I'll prepare a judgment. Thank you, Your Honor.

MR. MENDEZ: Thank you, Your Honor.

(p. 56) STATE OF TEXAS)
)
COUNTY OF TRAVIS)

I, VICTORIA A. HOLDER, a shorthand reporter and Notary Public for Travis County, Texas, do hereby certify that the above captioned matter came on for hearing before HONORABLE JOE B. DIBRELL, JR., Judge, in the 345th Judicial District of Travis County, Texas, as hereinafter set out.

I FURTHER CERTIFY that the proceedings of said hearing were reported by me, accurately reduced to typewriting under my supervision and control; and, that the

above and foregoing typewritten pages contain a full and correct transcription of my shorthand notes taken on said occasion.

GIVEN UNDER MY hand and seal of office this, the 25th day of February, 1986.

(p. 57) BRIGHT, FULLER & ASSOCIATES
708 Colorado, Suite 700,
Austin, Texas 78701
(512) 478-6971

/s/ Victoria A. Holder
VICTORIA A. HOLDER
Certified Court Reporter and
Notary Public in Travis County
for the State of Texas

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/s/ Victoria A. Holder

Supreme Court, U.S.
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No. 87-1245

In The
Supreme Court of the United States
October Term, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

BRIEF FOR APPELLANT

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QUESTIONS PRESENTED

1. Whether a state statute exempting from a general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith" unconstitutionally discriminates in the taxation of periodicals based on content under this Court's decision in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S. Ct. 1722 (1987).

2. Whether a state statute exempting from a general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith" is invalid as violative of the Establishment Clause of the First Amendment.

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October Term, 1987

TEXAS MONTHLY, INC.,

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BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

BRIEF FOR APPELLANT

OPINIONS BELOW

The opinion of the Texas Court of Appeals on rehearing, which appears in the Appendix to the Jurisdictional

[1]Appellant is a wholly-owned subsidiary of Mediatex Communications Corporation. Texas Monthly Press, Inc., Mediatex Development Corporation and Mediatex Broadcasting Corporation are Appellant's affiliated companies. Appellant has no subsidiaries and no other parent companies or affiliates.

Statement (J.S. App. 1), is reported at 731 S.W.2d 160 (Tex. App.—Austin 1987, writ ref'd n.r.e.). The original opinion of the Texas Court of Appeals dated March 18, 1987, which was subsequently withdrawn, is not reported. It is reprinted at J.S. App. 23.

The final judgment and the findings of fact and conclusions of law of the district court are not reported. They are reprinted at J.S. App. 42 and 46.

JURISDICTION

The judgment of the Texas Court of Appeals on rehearing was entered on May 27, 1987. The Court of Appeals overruled Appellant's timely filed motion for rehearing on June 24, 1987. Thereafter, on September 23, 1987, the Texas Supreme Court refused Appellant's timely filed application for writ of error with the notation, "no reversible error." A motion for rehearing was entertained and overruled on October 28, 1987.[2]

The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2).

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[2]This appeal is properly taken from the Texas Court of Appeals and not the Texas Supreme Court. *Interstate Circuit, Inc. v. City of Dallas*, 390 U.S. 676, 678 n.1 (1968); *Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S. 157, 160 (1954).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The First Amendment to the Constitution of the United States provides, in relevant part:

> Congress shall make no law respecting an establishment of religion . . . or abridging the freedom of speech, or of the press . . . .

The Fourteenth Amendment to the Constitution of the United States provides, in relevant part:

> No State shall . . . deny to any person within its jurisdiction the equal protection of the laws.

Section 151.312 of the Texas Tax Code provides:

> Periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religious faith are exempted from the taxes imposed by this chapter.

———o———

STATEMENT OF THE CASE

This is an appeal from a decision of a Texas Court of Appeals holding that a state statute exempting from a general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith" does not unconstitutionally discriminate in the taxation of periodicals based on content under this Court's decision in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S. Ct. 1722 (1987), nor violate the Establishment Clause of the First Amendment.

Effective October 2, 1984, the Texas legislature repealed an existing broad exemption from state sales tax for magazine subscription sales.[3] Remaining in effect, however, was an exemption for "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith." No other magazines were exempted.

Appellant publishes *Texas Monthly* magazine, a monthly general interest magazine with a circulation of approximately 280,000. While *Texas Monthly* magazine sometimes carries articles on religion, no issue of the magazine consists wholly of writings promulgating the teaching of a religious faith, and Appellant is not a "religious faith". Consequently, Appellant was required to collect and remit to the State a tax equal to 6.125% of the subscription sales price of its magazine.

In 1985, Appellant paid, under protest, sales taxes of $149,107.74 and, under the appropriate state procedure, brought this action to recover those taxes. One of the grounds for recovery was that the exemption for religious periodicals contained in Section 151.312 violated Appellant's rights under the First and Fourteenth Amendments to the Constitution of the United States. J.A. 6.

After a two day trial before the court, the district court entered judgment in favor of Appellant in the amount of

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[3]This exemption was reenacted by the Texas legislature effective October 1, 1987, and Appellant's subscription sales are thus currently exempt from state sales tax. Tax payments for the period the tax was in effect remain in controversy. In addition, sales of Appellant's magazine from a newsstand have been and continue to be subject to state sales tax.

$149,107.74, plus interest. J.S. App. 43. The court held that Section 151.312 of the Texas Tax Code was unconstitutional "because it constitutes an unlawful discrimination based on the content of [Appellant's] publication in violation of its rights under the First and Fourteenth Amendments of the U.S. Constitution. . . ." J.S. App. 42, 47.[4]

Appellees appealed to the Court of Appeals for the Third Supreme Judicial District of Texas, at Austin. A majority of the three-judge panel of the Court of Appeals reversed the judgment of the district court and rendered judgment for Appellees, upholding the constitutionality of Section 151.312. The court held that Section 151.312 did not unconstitutionally discriminate between periodicals based on content. The Texas court distinguished this Court's decision in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S. Ct. 1722 (1987), in which the Court struck down a state sales tax scheme that taxed general interest magazines but exempted "religious, professional, trade and sports journals." The Texas court, ignoring this Court's discussion of content-based discrimination in *Arkansas Writers' Project*, limited that case to situations in which: (i) a tax treats the press differently from other enterprises, or (ii) a tax targets a small group within

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[4]Appellant also sought to recover on the grounds that, as the sales and use tax system is applied by Appellees, the tax operates as a gross receipts tax on magazine subscription sales and discriminates against magazines published in Texas. J.A. 6; *see Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, 460 U.S. 575 (1983). The district court did not rule on either of these questions, having concluded that Appellant was entitled to relief because of the unconstitutionality of the religious periodical exemption. J.S. App. 44.

the press as a whole.[5] The Court of Appeals further held that Section 151.312 did not unconstitutionally favor religion in violation of the Establishment Clause of the First Amendment. The dissenting judge would have held the differential taxation of religious and other periodicals unconstitutional on Establishment Clause grounds.

Appellant reiterated its First and Fourteenth Amendment claims, including a claim that Section 151.312 violated the Establishment Clause, in its application for writ of error filed in the Texas Supreme Court. The Texas Supreme Court refused the application for writ of error with the notation, no reversible error.

SUMMARY OF ARGUMENT

I. Texas has a sales and use tax system that requires consumers to pay a tax upon the purchase or use of most tangible personal property. Texas Tax Code Ann. § 151.001, *et seq.* During the period involved in this case, magazines and other periodicals were subject to the tax, along with all other goods bought and used in Texas. Every person who bought or read a magazine in Texas was obligated to pay the tax except those people who purchased or read "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith." And all

[5]The evidence before the trial court was that there were 20 to 30 taxpayers that paid the tax. J.A. 100. The evidence at the trial established that the sales and use tax system in Texas operates to discriminate against magazines selling to subscribers in general and Texas-based publishers in particular. See J.A. 118-141.

of the publishers of magazines or periodicals that did not come within the exemption were obligated to collect the tax and remit the revenue to the State.

The exemption for religious periodicals is wholly inconsistent with the holding of this Court in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S. Ct. 1722 (1987), because the exemption discriminates on the basis of the content of the periodical. In *Arkansas Writers' Project* the Court pointed out that if the articles in *Arkansas Times* had been "uniformly devoted to religion," that magazine would not have been subject to the Arkansas tax, 107 S. Ct. at 1728. Here, if Texas Monthly, Inc. was a "religious faith" and its magazine devoted to the "teachings of a religious faith," the purchase or use of *Texas Monthly* would have been exempt from the sales and use tax.

Thus Section 151.312 suffers from the same flaw as did the Arkansas statute: "a magazine's tax status depends entirely on its *content*." 107 S. Ct. 1727. Texas, like Arkansas, "faces a heavy burden in attempting to defend its content-based approach to taxation of magazines. In order to justify such differential taxation, the State must show that its regulation is necessary to serve a compelling state interest and is narrowly drawn to achieve that end." *Id.* at 1728. The Texas exemption serves no compelling interest. It simply provides an unlawful subsidy to religious organizations and entangles state officials in religious affairs, disturbing the general system of taxing all sales of tangible goods by religious groups.

II. The Texas statute exempting from sales tax only those "periodicals that are published or distributed by

a religious faith and that consist wholly of writings promulgating the teaching of the faith" is also unconstitutional because it constitutes a "law respecting an establishment of religion." As this Court has pointed out, a tax exemption is similar to a direct governmental subsidy. *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 544 (1983). Payment of a subsidy by the goverment solely to promote religious messages, when no other messages are subsidized, clearly violates the Establishment Clause. The exemption thus is unlawful under the three-part test set forth in *Lemon v. Kurtzman*, 403 U.S. 602, 612-13 (1971), because it advances religion. It further results in excessive entanglement because it requires governmental ecclesiastical review as a prerequisite to its applicability.

ARGUMENT

1. The Texas sales tax scheme unconstitutionally discriminates between periodicals based on content.

The decision of the Texas Court of Appeals leaves standing a statutory sales tax scheme that grants or withholds a tax benefit based on a publication's *content*. Specifically, the state statute exempts from the general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith." This

tax scheme offends the First and Fourteenth Amendments.[6] Further, the holding of the Texas Court is directly contrary to this Court's decision in *Arkansas Writers' Project, Inc. v. Ragland,* 107 S. Ct. 1722 (1987), as well as other recent decisions of this Court.

The dangers posed to freedom of speech are manifest where the application of a tax depends on the content of speech. *See Speiser v. Randall,* 357 U.S. 513 (1957). This Court has not hesitated to condemn, as a threat to protected First Amendment expression, content-based discrimination. The Court has not minced words: In *Police Department of Chicago v. Mosley,* 408 U.S. 92, 95 (1972), the Court stated:

> But, above all else, the First Amendment means that government has no power to restrict expression because of its messages, its ideas, its subject matter, or its content.

Most recently, the Court held:

> [O]fficial scrutiny of the content of publications as the basis for imposing a tax is entirely incompatible with the First Amendment's guarantee of freedom of the press.

Arkansas Writers' Project, Inc. v. Ragland, supra, at 1728. These words express this Court's consistent refusal to condone discrimination based on the content of speech. *See, e.g., FCC v. League of Women Voters of California,* 468 U.S. 364 (1984) (statute prohibiting noncommercial

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[6]Appellant's First Amendment claims are necessarily entwined with interests arising under the Equal Protection Clause. The discussion below, in line with recent decisions of this Court, analyzes the Texas sales tax scheme primarily in First Amendment terms.

television and radio stations from editorializing unconstitutional as based on content of message); *Regan v. Time, Inc.*, 468 U.S. 641 (1984) (statute limiting use of photographs on paper currency to "philatelic, numismatic, educational, historical or newsworthy" purposes unconstitutionally permits government to discriminate on basis of content of message); *Police Department of Chicago v. Mosley*, 408 U.S. 92 (1972) (exemption from ban on picketing for labor disputes unconstitutional restriction based on content). Conversely, in cases upholding classifications affecting speech, the Court has carefully noted the absence of content-based discrimination. *See, e.g., Clark v. Community for Creative Non-Violence*, 468 U.S. 288, 295 (1984) (prohibition on camping content-neutral); *Members of City Council v. Taxpayers for Vincent*, 466 U.S. 789, 804 (1984) (ordinance prohibiting posting of signs on public property "viewpoint neutral"); *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 548, 551 (1983) (special tax status for veterans' organizations not related to content of speech).

In *Arkansas Writers' Project*, the Court struck down a state sales tax scheme that taxed general interest publications but exempted "religious, professional, trade and sports journals." The Court held that the tax targeted a small group within the press and was thus unconstitutional under the Court's decision in *Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, 460 U.S. 575 (1983). The Court went further:

> Indeed, this case involves a more disturbing use of selective taxation than *Minneapolis Star*, because the basis on which Arkansas differentiates between magazines is particularly repugnant to First Amendment

principles: a magazine's tax status depends entirely on its *content*.

• • •

If articles in *Arkansas Times* were uniformly devoted to religion or sports, the magazine would be exempt from the sales tax under § 84-1904(j). However, because the articles deal with a variety of subjects (sometimes including religion and sports), the Commissioner has determined that the magazine's sales may be taxed. In order to determine whether a magazine is subject to sales tax, Arkansas' "enforcement authorities must necessarily examine the content of the message that is conveyed. . . ." *FCC v. League of Women Voters of California*, 468 U.S. 364, 383, 104 S. Ct. 3106, 3119, 82 L.Ed.2d 278 (1984). Such official scrutiny of the content of publications as the basis for imposing a tax is entirely incompatible with the First Amendment's guarantee of freedom of the press. *See Regan v. Time, Inc., supra*, at 648, 104 S.Ct., at 3266.

107 S. Ct. 1727-28.

The Texas Court of Appeals, in analyzing the constitutionality of the Texas sales tax scheme which exempts only "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith," ignored this Court's condemnation of content-based discrimination set forth so clearly in *Arkansas Writers' Project*. The Court of Appeals instead read tha case as applying only to situations in which (i) a tax treats the press differently from other enterprises, or (ii) a tax targets a small group within the press as a whole.

While it is true that one basis for the Court's decision in *Arkansas Writers' Project* was the fact that only three publishers actually paid the tax, there is nothing in the

opinion to suggest that the limited burden of the tax was critical to the Court's conclusion that the Arkansas tax scheme unconstitutionally discriminated between publications on the basis of content. Rather, the Court said that the "more disturbing" aspect of the Arkansas statute was its scheme of applying the tax based on the "*content*" of the magazine. 107 S. Ct. 1727-28. This "more disturbing" aspect of the Arkansas statute existed whether three or three hundred magazines paid the tax. There is no connection between the two holdings. *See also*, *Regan v. Time, Inc.*, *supra*; *FCC v. League of Women Voters of California*, *supra*. Moreover, if, as the Texas Court of Appeals suggests, this Court's discussion of content-based discrimination in *Arkansas Writers' Project* was mere dictum, there would have been no need for plenary review in that case; summary reversal on the basis of *Minneapolis Star* would have been appropriate.

Appellant challenged the Texas sales tax on the basis that the tax was in practice paid by only a few publishers, relying on *Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, 460 U.S. 575 (1983). J.A. 6. Evidence adduced at trial established that, while many magazines were sold in the State, only twenty to thirty publishers paid the tax. J.A. 100. Because of its holding that the Texas tax unconstitutionally discriminated on the basis of content, the trial court found it unnecessary to decide the issue. J.S. App. 44. Nevertheless, whether content-based discrimination affects thirty publishers or only

three, the constitutional principle of content-based discrimination is the same.[7]

Rather than examine cases explicitly addressing content-based discrimination, the Texas Court of Appeals instead relied on this Court's decision in *Regan v. Taxation with Representation of Washington*, 461 U.S. 540 (1983), holding that failure to subsidize a fundamental right did not violate the First Amendment. The Texas court did so in spite of this Court's clear statement in *Regan* that the issue of content-based discrimination was not presented for review. 461 U.S. at 548 ("veterans' originations . . . are entitled to receive tax deductible contributions regardless of the content of any speech they may use"); 461 U.S. at 551 (concurring opinion) ("discrimination between veterans' organizations and charitable organizations is not based on the content of their speech"). The Texas tax scheme in specific and unambiguous terms requires the State to examine a publication's content to determine the availability of the exemption.

This case does not pose a situation where the government has chosen properly to subsidize certain messages, such as the "JUST SAY NO" anti-drug campaign, and not other messages it may subsidize. *See* Justice Scalia's dissent in *Arkansas Writers' Project*, 107 S. Ct. at 1731-32. Here, if the exemption is viewed as a subsidy, the Texas legislature has chosen to subsidize particular religious messages. Under this analysis Texas is making

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[7] In *Minneapolis Star & Tribune Co.*, the tax was imposed on eleven publishers one year and thirteen publishers the next. 460 U.S. at 578-79. There was no issue of content-based discrimination in that case.

a payment to "religious faiths" of six and one-eighth cents for every dollar received in payment for "teachings" they sell. The Establishment Clause clearly prohibits such a payment.

The Texas Court of Appeals' decision is further erroneous because it shifts to Appellant the burden to prove that the exemption applicable to religious publications infringes on Appellant's constitutional right of free speech. The decision conflicts with decisions of this Court in *Minneapolis Star* and *Arkansas Writers' Project*. In *Minneapolis Star*, this Court stated that a "tax that burdens rights protected by the First Amendment cannot stand unless the burden is necessary to achieve an overriding governmental interest." 460 U.S. at 582. In *Arkansas Writers' Project*, the Court held that:

> *Arkansas faces a heavy burden in attempting to defend its content-based approach to taxation of magazines.* In order to justify such differential taxation, the State must show that its regulation is necessary to serve a compelling state interest and is narrowly drawn to achieve that end.

107 S. Ct. at 1728 (emphasis supplied).

Texas has failed to prove "a compelling state interest" and to demonstrate that the statute is "narrowly drawn" to achieve that interest. Appellees have argued that the exemption of religious publications is necessary to avoid impermissible state entanglement under the Establishment Clause. Motion to Dismiss or Affirm at 8. But the exemption has just the opposite effect. It requires the State to determine whether the publisher is a "religious faith" and to examine the content of each pub-

lication to determine whether it is taxable or exempt. It is the exemption, and not the tax, that gives rise to entanglement.

There is no general exemption for items sold by religious organizations. J.A. 57-58. If a religious organization sells candles, crucifixes, canned goods or clothes, it collects and remits the tax. Thus, the spectre of tax liens and judicial seizure and sale, raised by Appellees' Motion to Dismiss or Affirm at 10, exists even if the exemption for religious periodicals did not exist.

The Court's recent decision in *Arkansas Writers' Project* mandates the result in this case. There is no basis for distinction. The judgment of the Texas Court of Appeals should be reversed, and the judgment of the trial court should be affirmed.

II. The exemption from tax for religious periodicals constitutes a "law respecting an establishment of religion."

Section 151.312 of the Texas Tax Code exempts from sales tax "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith" in violation of the Establishment Clause. The decision of the court below, upholding the exemption as constitutional, attacks the time-honored and constitutionally mandated separation of church and state.

This Court has created a three-part test to determine whether a statute violates the Establishment Clause:

> First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion, . . .

> finally, the statute must not foster "an excessive government entanglement with religion."

Lemon v. Kurtzman, 403 U.S. 602, 612-13 (1971). The Texas statute fails in all three respects. *See Edwards v. Aguillard*, 107 S. Ct. 2573 (1987).

First, there is no secular legislative purpose for the statute. Appellees have asserted a secular purpose of avoiding entanglement with religion. Motion to Dismiss or Affirm at 10. Yet it is clear that the State is not *required* to exempt all activities of religious groups from taxation. *See, e.g., Murdock v. Pennsylvania*, 319 U.S. 105, 112 (1943). The State of Texas has not, in fact, done so. Sales of tangible personal property by religious organizations are generally subject to sales tax.[8] Only sales of those magazines and books whose content complies with Section 151.312 are exempted from the tax.

Sales tax here is easily calculated on the basis of sales price regardless of the identity of the seller. The State is in fact required to collect tax on most sales by religious organizations. It is the exemption, and not the tax, which gives rise to examination and inquiry about religious faith and religious teaching. It is the exemption that creates entanglement.

Second, the exemption for religious periodicals advances religion because it singles out religion to receive a benefit not available to other charitable causes. This preference is far more restrictive than the broad exemptions

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[8]Tex. Tax Code Ann. § 151.310(c) permits a one day tax free sale or auction once a year by an educational or religious organization. Other sales are subject to tax. *See* J.A. 57-58.

considered by this Court in *Walz v. Tax Commission*, 397 U.S. 664, 672-73 (1970), in which the Court upheld a tax exemption granted to numerous "nonprofit, quasi-public corporations" that foster "moral or mental improvement" of the community at large. *See also Committee for Public Education v. Nyquist*, 413 U.S. 756, 794 (1973) ("narrowness of the benefited class would be an important factor"); *Gillette v. United States*, 401 U.S. 437, 454 (1971) (tax exemptions, like those in *Walz*, permissible "so long as an exemption is tailored broadly enough that it reflects valid secular purposes").

Tax exemptions have been compared by this Court to a subsidy. *Regan v. Taxation With Representation of Washington*, *supra*, 461 U.S. at 544; *Arkansas Writers' Project, Inc. v. Ragland*, *supra*, 107 S. Ct. at 1731 (Scalia, J., dissenting). There can be no doubt that decisions of this Court bar payment by the State of a subsidy to religious organizations. *See e.g., School District of City of Grand Rapids v. Ball*, 473 U.S. 373, 394, 395 (1985) (direct cash subsidy to religious school prohibited under Establishment Clause); *Committee for Public Education v. Nyquist*, 413 U.S. 756, 774-81 (1973). A more direct advancement of religion is difficult to imagine.

Third, the statute on its face requires excessive government entanglement with religion. The exemption requires the State to determine (i) whether the publisher or distributor is a "religious faith" and (ii) whether the contents of the publication consist "wholly of writings promulgating the teaching of the faith." As in *FCC v. League of Women Voters of California* and *Arkansas Writers' Project*, "enforcement authorities must necessarily examine the content of the message that is conveyed. . . ."

Appellees rely on the testimony of the woman who, at the time of trial, was the Supervisor for Sales Tax Policy in the Comptroller's office to avoid the entanglement issue. Mrs. Wanda Hutchinson testified:

> (Question as to what periodicals have been sent to the Comptroller's office.)
>
> A. I think what is sent in normally is the organization itself will give us the name of what is being published and ask us if that particular publication qualifies for a sales tax exemption.
>
> Q. And you decide?
>
> A. No sir. What we normally do is to see if the organization is a religious organization.
>
> Q. And if the religious organization—anything they publish you let come out under that exemption?
>
> A. What we tell them is we leave it to (p. 72) them to decide whether or not it's a religious—a publication or periodical that teaches their faith. We do not make that determination.
>
> Q. Because there's no—you don't have any authority to make it in advance of somebody trying to collect the tax from them?
>
> A. Well, I think it's mainly just because we don't want to get involved in deciding whether something is sacred to a religious faith or not.

J.A. 60-61.

The repugnancy to Mrs. Hutchinson of the task required by the clear statutory language and her unwillingness to enforce the letter of the law does not alter the statute nor guarantee that the next person who fills her post will not be more zealous. Mrs. Hutchinson's informal construction has never been issued as a regulation or rule

by the Comptroller, whose published rules essentially repeat the statutory language of Section 151.312. 34 Tex. Admin. Code § 3.299(d); J.S. App. 59. The majority of the Texas Court of Appeals found that this testimony could save the statute. But the exemption clearly requires a governmental official to evaluate the practices of the group seeking the exemption to determine whether it is a "religious faith." The tax official is also required to read what is written to see if it conforms to the teachings of that faith. A statute requiring more entanglement is difficult to imagine. If a court is prohibited by the First Amendment from deciding ecclesiastical questions, a state official certainly is prohibited from doing so. *See Presbyterian Church v. Hull Memorial Presbyterian Church*, 393 U.S. 440, 446 (1969).

But even assuming the practice of the tax supervisor holding that position at the time of trial is binding on the State,[9] it does not save the statute from unconstitutionality. Under the State's interpretation, the statute confers a special benefit only on religious organizations and achieves no other purpose. Such a construction renders the statute unconstitutional under the second prong of the *Lemon* test.

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[9]It is clear that under Texas law Mrs. Hutchinson's practice is not binding on the State. Departmental practice by Texas administrative agencies "affords no basis for practices which are contrary to the plain meaning of statutes." *Brown Express, Inc. v. Railroad Commission*, 415 S.W.2d 394, 397 (Tex. 1967). Moreover, the State is not estopped from collecting taxes lawfully due by statements of its employees, or even by adopted rules. *Central Power & Light Co. v. State*, 165 S.W.2d 920, 923 (Tex. Civ. App.—Austin 1942, writ ref'd); *Bullock v. Ensearch Exploration, Inc.*, 614 S.W.2d 215, 218 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.).

No. 87-1245-ASX
Status: GRANTED

Title: Texas Monthly, Inc., Appellant
v.
Bob Bullock, Comptroller of Public Accounts of the State of Texas, et al.

Docketed:
January 23, 1988

Court: Court of Appeals of Texas, Third District

Counsel for appellant: George Jr.,Roger James

Counsel for appellee: Burke,Harriet Dee

Entry	Date	Note	Proceedings and Orders
1	Jan 23 1988	G	Statement as to jurisdiction filed.
2	Feb 19 1988		Motion of appellees Bob Bullock, etc., et al. to dismiss or affirm filed.
4	Feb 19 1988	G	Motion of Magazine Publishers of America, Inc. for leave to file a brief as amicus curiae filed.
5	Feb 19 1988	G	Motion of American Booksellers Association, Inc. for leave to file a brief as amicus curiae filed.
3	Feb 24 1988		DISTRIBUTED. March 18, 1988
7	Mar 21 1988		Motion of Magazine Publishers of America, Inc. for leave to file a brief as amicus curiae GRANTED.
8	Mar 21 1988		Motion of American Booksellers Association, Inc. for leave to file a brief as amicus curiae GRANTED.
9	Mar 21 1988		PROBABLE JURISDICTION NOTED.
			**********
11	Apr 14 1988		Order extending time to file brief of appellant on the merits until June 2, 1988.
12	May 23 1988		Record filed.
		*	Certified copy of original record in appeal filed.
13	Jun 2 1988		Joint appendix filed.
14	Jun 2 1988		(Joint Appendix in Two Volumes.)
15	Jun 2 1988		Brief of appellant TX Monthly, Inc. filed.
17	Jun 2 1988		Brief amici curiae of ACLU, et al. filed.
18	Jun 2 1988	G	Motion of Magazine Publishers of America, Inc. for leave to file a brief as amicus curiae filed.
19	Jun 20 1988		Motion of Magazine Publishers of America, Inc. for leave to file a brief as amicus curiae GRANTED.
20	Jun 28 1988		Brief of appellees Bob Bullock, etc., et al. filed.
21	Jul 26 1988		CIRCULATED.
22	Aug 29 1988		Set for argument. Tuesday, November 1, 1988. (3rd case) (1 hr).
24	Oct 11 1988	D	Motion of appellant for leave to file a reply brief, out-of-time filed.
25	Oct 11 1988		DISTRIBUTED. October 14, 1988. (Motion of appellant for leave to file reply brief out-of-time).
26	Oct 17 1988		Motion of appellant for leave to file a reply brief, out-of-time DENIED.
27	Nov 1 1988		ARGUED.

Supreme Court, U.S.
FILED
JAN 29 1988
CLERK

No. 87-1245

In The
Supreme Court of the United States
October Term, 1987

TEXAS MONTHLY, INC.,
Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

1. Whether a state statute exempting from a general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith" unconstitutionally discriminates in the taxation of periodicals based on content under this Court's decision in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S.Ct. 1722 (1987).

2. Whether a state statute exempting from a general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith" is invalid as violative of the Establishment Clause of the First Amendment.

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No. .....

In The

Supreme Court of the United States

October Term, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

JURISDICTIONAL STATEMENT

Texas Monthly, Inc., the appellant,[1] appeals from the final judgment on rehearing of the Court of Appeals for the Third Supreme Judicial District of Texas, at Austin, dated May 27, 1987. That judgment held that Section 151.312 of the Texas Tax Code, which exempts from a general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of

[1]Appellant is a wholly-owned subsidiary of Mediatex Communications Corporation. Texas Monthly Press, Inc., Mediatex Development Corporation and Mediatex Broadcasting Corporation are appellant's affiliated companies. Appellant has no subsidiaries and no other parent companies or affiliates.

writings promulgating the teaching of the faith," does not discriminate in the taxation of periodicals based on content in violation of the First and Fourteenth Amendments to the United States Constitution nor does it violate the Establishment Clause of the First Amendment.

OPINIONS BELOW

The opinion of the Texas Court of Appeals on rehearing, which appears in the appendix hereto, p. App. 1, *infra*, is reported at 731 S.W.2d 160 (Tex. App.—Austin 1987, writ ref'd n.r.e.). The original opinion of the Texas Court of Appeals dated March 18, 1987, which was subsequently withdrawn, is not reported. It is reprinted in the appendix hereto, p. App. 23, *infra*.

The final judgment and the findings of fact and conclusions of law of the district court are not reported. They are reprinted in the appendix hereto, pp. App. 42 and 46, *infra*, respectively.

JURISDICTION

The original judgment of the Court of Appeals was entered on March 18, 1987. See p. App. 41, *infra*. Motions for rehearing and rehearing en banc were timely filed. The motion for rehearing en banc was overruled on May 6, 1987. See p. App. 50, *infra*. The motion for rehearing was overruled on May 27, 1987, the Court of Appeals with-

drawing its original opinion, substituting a new opinion and entering judgment on motion for rehearing. See p. App. 48, *infra*. A timely filed second motion for rehearing was overruled on June 24, 1987. See p. App. 51, *infra*.

Appellant timely filed an application for writ of error with the Texas Supreme Court, which application was refused on September 23, 1987 with the notation, no reversible error. See p. App. 52, *infra*. A motion for rehearing was entertained and overruled on October 28, 1987. See p. App. 53, *infra*.

A notice of appeal to this Court was timely filed in the Texas Court of Appeals on December 3, 1987. See p. App. 54, *infra*. This appeal is properly taken from the Texas Court of Appeals and not the Texas Supreme Court. *Interstate Circuit, Inc. v. City of Dallas*, 390 U.S. 676, 678 n.1 (1968); *Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S. 157, 160 (1954).

This appeal is being docketed in this Court within 90 days from the denial of rehearing below. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The First Amendment to the Constitution of the United States provides in relevant part:

> Congress shall make no law respecting an establishment of religion . . . or abridging the freedom of speech, or of the press . . . .

The Fourteenth Amendment to the Constitution of the United States provides, in relevant part:

> No State shall . . . deny to any person within its jurisdiction the equal protection of the laws.

Section 151.312 of the Texas Tax Code provides:

> Periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religious faith are exempted from the taxes imposed by this chapter.

STATEMENT OF THE CASE

This is an appeal from a decision of a Texas Court of Appeals holding that a state statute exempting from a general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith" does not unconstitutionally discriminate in the taxation of periodicals based on content under this Court's decision in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S.Ct. 1722 (1987), nor violate the Establishment Clause of the First Amendment.

Effective October 2, 1984, the Texas legislature repealed an existing broad exemption from state sales tax for magazine subscription sales.[2] Remaining in effect,

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[2]This exemption was reenacted by the Texas legislature effective October 1, 1987, and appellant's subscription sales are thus currently exempt from state sales tax. Tax payments for the period the tax was in effect remain in controversy.

however, was an exemption for certain periodicals of a religious nature. No other magazines were exempted.

Appellant publishes *Texas Monthly* magazine, a monthly general interest magazine with circulation of approximately 280,000. *Texas Monthly* magazine features articles on a vast array of subjects, including religion. Appellant is not, however, a "religious faith" nor does its magazine consist wholly of writings promulgating the teaching of a religious faith. Consequently, appellant was required to collect and remit to the State sales tax on its subscription sales beginning October 2, 1984.

In 1985, appellant paid, under protest, sales taxes totalling $149,107.74 to the State. Accompanying each payment was a letter setting forth the grounds for protesting the tax. One of the grounds stated was that Section 151.312, exempting from the sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith," resulted in discriminatory taxation of periodicals based on content in violation of the First and Fourteenth Amendments to the Constitution of the United States.

Appellant filed suit in the district court of Travis County, Texas, 345th Judicial District, seeking refund of the taxes paid under protest, stating as a basis therefor the unconstitutional discrimination in taxation of magazines based on content. The district court entered judgment in favor of appellant in the amount of $149,107.74, plus interest. P. App. 43, *infra*. The court held Section 151.312 of the Texas Tax Code unconstitutional "because it constitutes an unlawful discrimination based on the con-

tent of [appellant's] publication in violation of its rights under the First and Fourteenth Amendments of the U.S. Constitution." P. App. 42; see also Findings of Fact and Conclusions of Law, p. App. 47.

Appellees brought an appeal in the Court of Appeals for the Third Supreme Judicial District of Texas, at Austin. A majority of the three-judge panel of the Court of Appeals reversed the judgment of the district court and rendered judgment for appellees, upholding the constitutionality of Section 151.312. The court held that Section 151.312 did not unconstitutionally discriminate between periodicals based on content. The Texas court distinguished this Court's decision in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S.Ct. 1722 (1987), in which the Court struck down a state sales tax scheme that taxed general interest magazines but exempted "religious, professional, trade and sports journals." The Texas court, ignoring this Court's discussion of content-based discrimination in *Arkansas Writers' Project*, limited that case to situations in which: (i) a tax treats the press differently from other enterprises, or (ii) a tax targets a small group within the press as a whole. The Court of Appeals further held that Section 151.312 did not unconstitutionally favor religion in violation of the Establishment Clause of the First Amendment. The dissenting judge would have held the differential taxation of religious and other periodicals unconstitutional on Establishment Clause grounds.

Appellant reiterated its First and Fourteenth Amendment claims, including a claim that Section 151.312 violated the Establishment Clause, in its application for writ of error filed in the Texas Supreme Court. The Texas

Supreme Court refused the application for writ of error with the notation, no reversible error.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

I. The Texas sales tax scheme unconstitutionally discriminates between periodicals based on content

The decision of the Texas Court of Appeals leaves standing a statutory sales tax scheme that grants or withholds a tax benefit based on a publication's *content*. This tax scheme offends the First and Fourteenth Amendments[3] and conflicts with recent decisions of this Court.

This case tests the limits of this Court's decision in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S.Ct. 1722 (1987). In *Arkansas Writers' Project*, the Court struck down a state sales tax scheme that taxed general interest publications but exempted "religious, professional, trade and sports journals." The Court held that the tax targeted a small group within the press and was thus unconstitutional under the Court's decision in *Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, 460 U.S. 575 (1983). The Court further held that:

> Indeed, this case involves a more disturbing use of selective taxation than *Minneapolis Star*, because the basis on which Arkansas differentiates between maga-

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[3]Appellant's First Amendment claims are necessarily entwined with interests arising under the Equal Protection Clause. The discussion below, in line with recent decisions of this Court, analyzes the Texas sales tax scheme primarily in First Amendment terms.

> zines is particularly repugnant to First Amendment principles: a magazine's tax status depends entirely on its *content*. . . .
>
> If articles in *Arkansas Times* were uniformly devoted to religion or sports, the magazines would be exempt from the sales tax under § 84-1904(j). However, because the articles deal with a variety of subjects (sometimes including religion and sports), the Commissioner has determined that the magazine's sales may be taxed. In order to determine whether a magazine is subject to sales tax, Arkansas' "enforcement authorities must necessarily examine the content of the message that is conveyed . . . ." *FCC v. League of Women Voters of California*, 468 U.S. 364, 383, 104 S.Ct. 3106, 3119, 82 L.Ed.2d 278 (1984). Such official scrutiny of the content of publications as the basis for imposing a tax is entirely incompatible with the First Amendment's guarantee of freedom of the press. *See Regan v. Time, Inc., supra*, at 648, 104 S.Ct., at 3266.

107 S.Ct. 1727-28. *Arkansas Writers' Project* and a long line of decisions from this Court make clear that the First Amendment will not tolerate discrimination based on content. *See, e.g., FCC v. League of Women Voters*, 468 U.S. 364 (1984) (statute prohibiting noncommercial television and radio stations from editorializing unconstitutional as based on content of message); *Regan v. Time, Inc.*, 468 U.S. 641 (1984) (statute limiting use of photographs of paper currency to "philatelic, numismatic, educational, historical or newsworthy" purposes unconstitutionally permits government to discriminate on basis of content of message); *Police Department of Chicago v. Mosley*, 408 U.S. 92 (1972) (exemption from ban on picketing for labor disputes unconstitutional restriction based on content).

The Texas Court of Appeals, in analyzing the constitutionality of the Texas sales tax scheme which exempts

only "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith," ignored this Court's condemnation of content-based discrimination set forth so clearly in *Arkansas Writers' Project*. The Court of Appeals instead read that case as applying only to situations in which (i) a tax treats the press differently from other enterprises, or (ii) a tax targets a small group within the press as a whole. The Texas Court effectively reduced to dictum this Court's holding in *Arkansas Writers' Project* that taxation based on a publication's content violates the First Amendment. But if the Texas Court were correct in its conclusion that this Court's discussion of content-based discrimination was mere dictum, there would have been no need for plenary review in *Arkansas Writers' Project*. Summary reversal on the basis of *Minneapolis Star* would have been appropriate, given that case condemned the two situations identified by the Texas Court of Appeals.

Rather than examine cases explicitly addressing content-based discrimination, the Texas Court of Appeals instead relied on this Court's decision in *Regan v. Taxation with Representation*, 461 U.S. 540 (1983), holding that failure to subsidize a fundamental right did not violate the First Amendment. The Texas court did so in spite of this Court's clear statement in *Regan* that the issue of content-based discrimination was not presented for review. 461 U.S. at 548 ("veterans' organizations . . . are entitled to receive tax deductible contributions regardless of the content of any speech they may use"); 461 U.S. at 551 (concurring opinion) ("discrimination between veterans' organizations and charitable organizations is not based on the content of their speech"). The Texas tax scheme in

specific and unambiguous terms requires the State to examine a publication's content to determine the availability of the exemption.

The Texas Court of Appeals' decision shifts to the appellant the burden to prove that the exemption applicable to religious publications infringes on appellant's constitutional right of free speech. The decision conflicts with decisions of this Court in *Minneapolis Star* and *Arkansas Writers' Project*. In *Minneapolis Star* this Court stated that a "tax that burdens rights protected by the First Amendment cannot stand unless the burden is necessary to achieve an overriding governmental interest." 460 U.S. at 582. In *Arkansas Writers' Project*, the Court held that:

> *Arkansas faces a heavy burden in attempting to defend its content-based approach to taxation of magazines.* In order to justify such differential taxation, the State must show that its regulation is necessary to serve a compelling state interest and is narrowly drawn to achieve that end.

107 S.Ct. at 1728 (emphasis supplied).

Texas has failed to prove "a compelling state interest" and to demonstrate that the statute is "narrowly drawn" to achieve that interest. Appellees argued below that the exemption of religious publications is necessary to avoid impermissible state entanglement under the Establishment Clause. While the State's goal is worthy, its method is faulty. The exemption requires the State to determine whether the publisher is a "religious faith" and to examine the content of each publication to determine whether it is taxable or exempt. It is the exemption, and not the tax, that gives rise to entanglement.

II. The exemption from tax for religious periodicals constitutes a law "respecting an establishment of religion"

Section 151.312 of the Texas Tax Code exempts from sales tax "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith" in violation of the Establishment Clause. The decision of the court below, upholding the exemption as constitutional, attacks the time-honored and constitutionally mandated separation of church and state.

This Court has created a three-part test to determine whether a statute violates the Establishment Clause:

> First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion, . . . finally, the statute must not foster "an excessive government entanglement with religion."

Lemon v. Kurtzman, 403 U.S. 602, 612-13 (1971). The Texas statute fails in all three respects. *See Edwards v. Aguillard*, 107 S. Ct. 2573 (1987).

First, there is no secular legislative purpose for the statute. Appellees asserted in the courts below a secular purpose of avoiding entanglement with religion.[4] Yet it is clear that the State is not *required* to exempt all activities of religious groups from taxation. *See, e.g., Murdock v. Pennsylvania*, 319 U.S. 105, 112 (1943). Indeed, sales tax here is easily calculated on the basis of sales price regard-

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[4]Appellees, however, have offered no citation to the exemption's legislative history to support this assertion.

less of the identity of the seller. It is the exemption, and not the tax, which gives rise to examination and inquiry about religious faith and religious teaching. It is the exemption that creates entanglement.

Second, the exemption for religious periodicals advances religion because it singles out religion to receive a benefit not available to other charitable causes. This preference is far more restrictive than the broad exemptions considered by this Court in *Walz v. Tax Commission*, 397 U.S. 664, 672-73 (1970), in which the Court upheld a tax exemption granted to numerous "nonprofit, quasi-public corporations" that foster "moral and mental improvement" of the community at large. *See also Committee for Public Education v. Nyquist*, 413 U.S. 756, 794 (1973) ("narrowness of the benefited class an important factor"); *Gillette v. United States*, 401 U.S. 437, 454 (1971) (tax exemptions, like those in *Walz*, permissible "so long as an exemption is tailored broadly enough that it reflects valid secular purposes").

Third, the statute on its face requires excessive government entanglement with religion. The exemption requires the State to determine (i) whether the publisher or distributor is a "religious faith" and (ii) whether the contents of the publication consist "wholly of writings promulgating the teaching of the faith." As in *FCC v. League of Women Voters* and *Arkansas Writers' Project*, "enforcement authorities must necessarily examine the content of the message that is conveyed. . . ."

Appellees sought below to avoid the entanglement issue by offering testimony of the current supervisor for sales tax policy in the Comptroller's office that she allows

an organization that qualifies as a "religious organization" under the general eleemosynary activities exemption, Section 151.310 of the Texas Tax Code, to claim exemption under the religious writing exemption, Section 151.312, for anything it publishes. This informal construction has never been issued as a regulation or rule by the Comptroller, whose published rules essentially repeat the statutory language of Section 151.312. 34 Tex. Admin. Code § 3.299(d); p. App. 59, *infra*. The majority of the Texas Court of Appeals found that this testimony could save the statute. But the exemption clearly requires a governmental official to evaluate the practices of the group seeking the exemption to determine whether it is a "religious faith." The tax official is also required to read what is written to see if it conforms to the teachings of that faith. A statute requiring more entanglement is difficult to imagine. If a court is prohibited by the First Amendment from deciding ecclesiastical questions, a state official certainly is prohibited from doing so. *See Presbyterian Church v. Hull Memorial Presbyterian Church*, 393 U.S. 440, 446 (1969).

But even assuming the practice of the tax supervisor holding that position at the time of trial is binding on the State,[5] it does not save the statute from unconstitution-

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[5]Appellant asserts it is not binding under Texas law. Departmental practice by Texas administrative agencies "affords no basis for practices which are contrary to the plain meaning of statutes." *Brown Express, Inc. v. Railroad Commission*, 415 S.W. 2d 394, 397 (Tex. 1967). Moreover, the State is not estopped from collecting taxes lawfully due by statements of its employees, or even by adopted rules. *Central Power & Light Co. v. State*, 165 S.W.2d 920, 923 (Tex. Civ. App—Austin 1942, writ ref'd); *Bullock v. Ensearch Exploration, Inc.*, 614 S.W.2d 215, 218 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.).

ality. Under the State's interpretation, the statute confers a special benefit only on religious organizations and achieves no other purpose. Such a construction renders the statute unconstitutional under the second prong of the *Lemon* test.

CONCLUSION

The judgment below upholding the exemption from taxation of religious publications based on content is clearly contrary to decisions of this Court and should be summarily reversed and sent back to the Texas Court of Appeals to award a refund to appellant of taxes paid under protest. Alternatively, this appeal should be awarded plenary review.

Respectfully submitted,

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APPENDIX A

IN THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

ON MOTION FOR REHEARING

NO. 14,692

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS AND ANN RICHARDS, TREASURER OF THE STATE OF TEXAS,

APPELLANTS

vs.

TEXAS MONTHLY, INC.,

APPELLEE

FROM THE DISTRICT COURT OF TRAVIS COUNTY, 345TH JUDICIAL DISTRICT, NO. 378,384, HONORABLE JOE B. DIBRELL, JR., JUDGE

The opinion handed down by this Court on March 18, 1987, is withdrawn and this opinion is filed in its place.

Appellee, Texas Monthly, Inc., sued the Comptroller of Public Accounts and others in the district court of Travis County seeking recovery of sales taxes paid under protest. After trial to the court, the district court rendered judgment that Texas Monthly recover $149,107.74. This Court will reverse the judgment.

Texas Monthly publishes a general interest magazine on a monthly basis. Effective October 2, 1984, the sales of its magazine became subject to the sales tax. Tex. Tax Code

Ann. § 151.051 (Supp. 1987). Texas Monthly paid, under protest, $149,107.74 which sum represented the tax on the sale of its magazine between January 21, 1985 and December 18, 1985.

Texas Monthly's suit for refund was predicated upon the fact that certain publications are exempted from payment of the sales tax. Tex. Tax Code Ann. § 151.312. That section provides:

> Periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religion or religious faith are exempted from the taxes imposed by this Chapter.

In its trial petition, Texas Monthly pleaded that:

> Section 151.312 exempts from the sales tax religious periodicals. Such an exemption constitutes an unlawful discrimination based on the content of a publication and thus violates Plaintiff's rights guaranteed by the First and Fourteenth Amendments to the Constitution of the United States and Article 1, § 8 of the Constitution of Texas.

The district court's judgment declared § 151.312 unconstitutional "because it constitutes an unlawful discrimination based on the content of [Texas Monthly's] publication in violation of its rights under the First and Fourteenth Amendments of the U.S. Constitution and Article VIII § 1 of the Texas Constitution. . . ."

Although the trial petition and the judgment are not entirely clear, the Comptroller and Texas Monthly in their briefs and oral argument took the position that the district court's judgment was grounded upon the premise that the § 151.312 exemption violated the equal protection and free

speech clauses of the First and Fourteenth Amendments to the Constitution of the United States and the equal and uniform clause of Article 8 § 1 of the Constitution of Texas. In its brief, Texas Monthly discusses the establishment clause of the First Amendment but only as a part of its equal protection analysis.

Under point of error one, the Comptroller first asserts that the district court erred in concluding that § 151.312 violated the equal protection clause of the United States Constitution and the equal and uniform clause of the Texas Constitution. We agree.

It is inherent in the exercise of the power to tax that a state be free to select the subjects of taxation and to grant exemptions. Equal protection does not impose on a state any rigid equality of taxation. Inequalities which result from singling out one particular class for taxation or exemption infringe no constitutional limitation. Carmichael v. Southern Coal & Coke Co., 301 U.S. 495 (1936). Like considerations govern exemptions from the operation of a tax imposed on the members of a class. The legislature is not bound to tax every member of a class or none at all. The legislature may make rational distinctions of degree having a rational basis. Carmichael v. Southern Coal & Coke Co., *supra;* Hurt v. Cooper, 110 S.W.2d 896 (Tex. 1937); American Transfer & Storage Co. v. Bullock, 525 S.W.2d 918 (Tex. Civ. App. 1975, writ ref'd). The exemptions, when subjected to judicial scrutiny, must be presumed to rest on a rational basis if any state of facts would support such basis. Carmichael v. Southern Coal & Coke Co., *supra*. Indeed, it is said that "the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimina-

tion against persons and classes. The burden is on the one attacking the legislative arrangement to negate every conceivable basis which might support it." Madden v. Kentucky, 309 U.S. 83 (1940).

In its effort to meet this burden, Texas Monthly suggests that the § 151.312 exemption constitutes a law "respecting an establishment of religion," in violation of the United States Constitution,[1] and therefore is unsupported by any legitimate basis.

The United States Supreme Court has created a three-part test to aid in determining whether a statute violates the establishment clause:

> First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion, . . . finally, the statute must not foster "an excessive entanglement with religion."

Lemon v. Kurtzman, 403 U.S. 602, 612-13 (1971). "Each value judgment under the religion clauses must . . . turn on whether particular acts in question are intended to establish or interfere with religious beliefs and practices or have the effect of doing so." Walz v. Tax Commission, 397 U.S. 664, 669 (1970). Applying this criteria, this Court concludes that § 151.312 does not violate the establishment clause. Furthermore, we are of the view that the classification established by this tax exemption has a rational basis and, accordingly, does not deny appellee equal protection of the law.

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[1] United States Const. amend. I states in part: "Congress shall make no law respecting an establishment of religion . . . . . "

The secular purpose served by a tax exemption for religious organizations was described in *Walz*, *supra*. In *Walz* the Supreme Court reasoned that such a tax exemption "restricts the fiscal relationship between church and state, and tends to complement and reinforce *the desired separation insulating each from the other*." *Id.* at 676 (emphasis supplied).

Furthermore, the opinion in *Walz* demonstrates that the tax exemption at issue does not have the primary effect of advancing or inhibiting religion. To the contrary, the effect of religious tax exemptions such as § 151.312 is to permit religious organizations to be independent of government support or sanction. Although *Walz* recognized that "[g]ranting tax exemptions to churches necessarily operates to afford [them] an indirect economic benefit," the Court concluded that

> [t]he grant of a tax exemption is not sponsorship since the government does not transfer part of its revenue to churches but simply abstains from demanding that the church support the state. No one has ever suggested that tax exemption has converted libraries, art galleries, or hospitals into arms of the state . . . .

Id. at 674-75.

Nor does the fact that *Walz* involved an exemption granted to other "nonprofit, quasi-public corporations," as well as to religious groups, distinguish it from this appeal. Although the broader based exemption in *Walz* provided a clearer case of non-sponsorship than is here present, the *neutrality* toward religion effected by the grant of an exemption for religious periodicals is just as evident. To discover an advancement of religion in this statutory scheme is to turn the intent and effect of § 151.312 on its head.

Finally, this Court concludes that § 151.312 does not excessively entangle the state in religious activities and, accordingly, the statute meets the third prong of the *Lemon v. Kurtzman* test. Once again, we refer to *Walz* as authority for our view. In *Walz* the Court noted that, generally, the grant of an exemption to religious organizations leads to lesser involvement by the State than does taxation. Nevertheless, "[i]n analyzing either alternative the questions are whether the involvement is excessive, and whether it is a continuing one calling for official and continuing surveillance leading to an impermissible degree of entanglement." *Id.* at 675. This analysis involves examination of "the character and purposes of the institutions that are benefitted, the nature of the aid that the State provides, and the resulting relationship between the government and the religious authority." *Lemon, supra* at 615.

To the extent § 151.312 creates entanglement, it creates entanglement between government and institutions with purely religious purposes. We are not faced, therefore, with the difficulties presented when the government attempts to limit its intrusion to the secular endeavors of a religious organization—for example, where government attempts to provide aid for the non-religious curriculum of sectarian schools and yet creates excessive entanglement by oversight measures intended to insure that the aid is not directed to religious purposes. *See Lemon, supra;* Meek v. Pittenger, 421 U.S. 349, 372 (1975). Accordingly, our focus is on the nature of the State's aid and the relationship between the State and religious publishers that results from the aid.

The aid at issue is, of course, the indirect subsidy provided by the tax exemption to religious periodicals. No affirmative action by state government is necessary to bestow this benefit. Due to its passive nature, the tax exemption does not create the appearance of an ongoing partnership between the State and religion presented by direct aid. More important, the exemption is administered in such a manner that "official and continuing surveillance" by the government is avoided.

Wanda Hutcheson, supervisor for sales tax policy in the Comptroller's Office, testified that religious publishers may qualify for an exemption by making a one-time showing that they are a bona fide religious organization under Tex. Tax Code Ann. § 151.310. Hutcheson further testified that "we leave it to [the organization] to decide whether or not it's . . . a publication that teaches their faith."

The Comptroller's application of § 151.312 in no manner resembles the "comprehensive, discriminating, and continuing state surveillance" which confronted the Supreme Court in *Lemon*. *Id.* at 619. In *Lemon*, the State had conditioned its direct aid to nonpublic schools with "pervasive" restrictions and a continuing right to inspect and audit school records. In contrast, our record demonstrates that the exemption is administered with a minimum of church-state entanglement and with an eye toward the goal of state neutrality codified in § 151.312 and elaborated in *Walz*.

Because the record in this appeal reveals "no realistic likelihood" that § 151.312 is enforced in such a way as to allow impermissible entanglement, this Court concludes that the Comptroller has met the third prong of the *Lemon*

test. *See* Hunt v. McNair, 413 U.S. 734, 747-48 (1973) (statute was constitutional where administrative scheme negated possibility that breadth of statute would lead to excessive entanglement).

The policy of neutrality toward religion embodied in § 151.312 provides a rational basis for the exemption and defeats any claim that the exemption violates the establishment clause. Accordingly, we conclude that § 151.312 does not deny appellee equal protection of the laws, nor does it violate the equal and uniform clause of the Texas Constitution.

Also under its first point of error, the Comptroller asserts that the district court erred in concluding that the § 151.312 exemption violated the free speech clause of the First Amendment. We agree.

This issue is controlled by the holding of the United States Supreme Court in Regan v. Taxation with Representation of Washington, 461 U.S. 540 (1983). *Regan* involved the validity of Internal Revenue Code provisions which allowed contributions to tax exempt organizations to be tax deductible only if the organization did not engage in lobbying. Taxation With Representation claimed the denial of this tax benefit was an "unconstitutional condition" on its exercise of free speech through lobbying. The Supreme Court rejected this claim, stating that "[t]his Court has never held that Congress must *grant a benefit* such as [Taxation With Representation] claims here to a person who wishes to exercise a constitutional right." *Id.* at 545 (emphasis supplied). In short, the Supreme Court held that the failure of the State to *subsidize* speech does not significantly interefere with First Amendment rights.

The same logic applies to § 151.312 of the Tax Code. The legislature has chosen to grant a tax benefit to religious publications. However, Texas Monthly has not shown that the legislature's failure to grant this benefit to other types of publications has "coerced" them into restricting their right of free speech. *Cf.* Speiser v. Randall, 357 U.S. 513 (1958). The first point of error is sustained.

On motion for rehearing, Texas Monthly contends that the opinion of the Supreme Court of the United States in Arkansas Writers' Project, Inc. v. Ragland, No. 85-1370, U.S. Sup. Ct., April 22, 1987 (not yet reported) is dispositive of its claim that § 151.312 violates its right of free speech. Texas Monthly's position is predicated on a misinterpretation of *Ragland*.

In *Ragland*, the Supreme Court identified two impermissible types of discrimination against the press:

(1) a tax which treats the press differently from other enterprises;

(2) a tax which targets a small group within the press as a whole.

The Supreme Court determined that the tax exemption in *Ragland* was so broad that it had the effect of singling out a very small group of magazines for *taxation*. This appeal, to the contrary, presents the opposite situation. The great mass of publishers remain subject to the sales tax. The legislature has rationally determined to *exempt* religious periodicals as a means of furthering the separation of church and state. Neither of the situations deemed objectionable by the Supreme Court in *Ragland* is presented in this appeal. As stated in the original opinion,

this appeal falls within the Supreme Court's holding in *Regan v. Taxation With Representation of Washington, supra.*

Texas Monthly points out further that this Court failed in the original opinion to address the issue of whether the tax exemption at issue violates the free speech provisions of the Texas Constitution, Tex. Const. Ann. art. 1, § 8 (1984). This Court has discovered no Texas authority addressing this issue. Texas Monthly's motion for rehearing relies almost entirely on analysis of federal opinions to support its position that Article 1, § 8 has been violated. Moreover, Article 1, § 8, as it respects limitations on the *government's* right to restrict speech, is stated in terms practically identical to the free speech clause of the First Amendment.

Under these circumstances, this Court will rely on federal law for guidance, *See* Jones v. Memorial Hospital System, 677 S.W.2d 221 (Tex. App. 1984, no writ). We conclude that the analysis set forth in *Regan v. Taxation With Representation, supra,* applies with equal force to Texas Monthly's challenge under Article 1, § 8. Accordingly, we sustain the Comptroller's point of error number one, as it relates to the district court's conclusion that § 151.312 violates Article 1, § 8 of the Texas Constitution.

In its prayer for relief, Texas Monthly, of course, asked that this Court affirm the district court's judgment. If, however, this Court concluded that the district court erred respecting § 151.312, Texas Monthly then requested that we remand the cause to district court for its consideration of issues raised but not there determined.

At oral submission, the Court inquired of counsel whether Texas Monthly had preserved its complaint concerning the issues not determined by the district court. By way of answer counsel requested, and obtained, leave to file a post-submission brief.

It is true that Texas Monthly pleaded that it was entitled to recovery of the taxes based upon one of several grounds. It is likewise true that the district court predicated its judgment upon only one such ground—the claimed unconstitutionality of § 151.312. Texas Monthly, however, did not complain in district court of the court's failure to consider and pass on its other asserted grounds of recovery, nor did it assert any such complaints by cross-points in this Court.

The trial court, of course, should be afforded an opportunity to correct any errors that it might have made in the judgment. Accordingly, to complain of the judgment on appeal, an appellee is required to bring those errors to the trial court's attention in some manner whether by filing exceptions to the judgment, notice of appeal, motion for new trial, or other. West Texas Utilities Co. v. Irvin, 336 S.W.2d 609 (Tex. 1960); Saenz Motors v. Big H. Auto Auction, Inc., 653 S.W.2d 521, 526 (Tex. App. 1983), *aff'd* 665 S.W.2d 756 (Tex. 1984); State Bar of Texas, Appellate Procedure in Texas § 15.16 at 351 (2nd ed. 1979). *See* Luna v. Southern Pacific Transportation Co., 724 S.W.2d 383 (Tex. 1987).

Contrary to appellee's argument in its motion for rehearing, the fact that this Court granted appellee leave to file a post-submission brief does not somehow supply

the missing trial court predicate for the assertion of cross-points in this Court nor does it cure appellee's failure to complain by cross-points in this Court of the trial court's failure to rule on its additional grounds of recovery.

Accordingly, Texas Monthly waived any right it may have had to require the district court to consider and pass on its other grounds of recovery. State Bar of Texas, Appellate Procedure in Texas § 15.16 at 351 (2nd ed. 1979).

The judgment of the district court is reversed and judgment is here rendered that Texas Monthly take nothing.

/s/ Bob Shannon
Chief Justice

[Before Chief Justice Shannon, Justices Brady and Carroll]

Reversed and Rendered on Motion for Rehearing

Filed: May 27, 1987

[Publish]

IN THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

NO. 14,692

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS AND ANN RICHARDS, TREASURER OF THE STATE OF TEXAS,

APPELLANTS

vs.

TEXAS MONTHLY, INC.,

APPELLEE

FROM THE DISTRICT COURT OF TRAVIS COUNTY, 345TH JUDICIAL DISTRICT, NO. 378,384, HONORABLE JOE B. DIBRELL, JR., JUDGE

DISSENTING OPINION

I respectfully dissent. I am particularly troubled by the impermissible intrusion of the State into religious affairs mandated by the *express terms* of § 151.312. Before allowing an exemption under § 151.312, the Comptroller must not only determine whether a bona fide "religious faith" is distributing the periodical, he must also assess whether the publication consists "wholly" of writings promulgating the teachings of the "religious faith."

The First Amendment of the United States Constitution provides:

> Congress shall make *no law respecting an establishment of religion*, or prohibiting the free exercise thereof . . .

This language does not contemplate that the government may nonetheless pass laws respecting an establishment of religion *so long as* government officials fairly administer the law. It is important for the continued ability of all people to worship as they choose that no state official be allowed to determine what is and what is not a religion.

I find § 151.312 unconstitutional under the establishment clause of the First Amendment for two basic reasons.[1] First, and foremost, the exemption engenders impermissible state entanglement with religion. Second, as written, § 151.312 has a constitutionally prohibited primary effect of advancing religion.

ENTANGLEMENT

The majority correctly indicates that in determining whether the entanglement engendered by state legislation is constitutionally impermissible, *i.e.*, continuing and excessive, one must look at the character and purpose of the benefited institutions, the nature of the aid, and the resulting relationship between the state and the religious entity. Here, the benefited institutions are *only* religious organizations. Furthermore, the state aid given is tax favoritism, which has been described as a subsidy. *See* Regan v. Taxation With Representation, 461 U.S. 540, 544 (1983). The resulting relationship is by no means passive since the statute requires the Comptroller to continually examine religious periodicals and the "religious faiths" promulgating them to determine whether they meet the statutory prerequisites of consisting "wholly" of the teachings of the "religious faith." By *requiring* the Comptroller to inquire into the dogma and belief of a religious

faith, § 151.312 results in *extensive* and *impermissible* state involvement with religion.

It is irrelevant what a given employee of the Comptroller's Office testifies to how an exemption will be administered. Over the course of time many such individuals will administer and interpret the exemption. We cannot under the First Amendment allow shadowy government officials to determine what is a religious faith and what writings are true to the faith's doctrine. *See* Presbyterian Church v. Hull Church, 393 U.S. 440 (1969). Hence, unlike in Hunt v. McNair, 413 U.S. 734 (1973), the institutions regulated here are more than just permeated with a substantial religious character—they are religious organizations.

The language in the Bill of Rights was not drafted on the assumption that government will exercise power properly, but against the possible reality that the power to rule may be abused. The First Amendment does not simply prohibit the establishment of a state church or a state religion, instead it commands that there should be "no law *respecting* an establishment of religion." A given law might not *establish* a state religion but it may nevertheless be one "respecting" that end in the sense of being a step that could lead to such establishment and hence offend the First Amendment. Lemon v. Kurtzman, 403 U.S. 602, 612 (1971). The "perception" that government is aiding religion is enough to strike a law as violating the establishment clause. *Cf.* Grand Rapids School Dist. v. Ball, 105 S.Ct. 3216, 3226 (1985). No ongoing partnership needs to be shown.

PRIMARY EFFECT

Inherent in the First Amendment is an antagonism between the command not to establish a religion and the command not to inhibit its practice. Either religion clause if expanded to its logical extreme would tend to clash with the other. As a result of this tension, state actions must maintain an attitude of "neutrality," neither *advancing* nor *inhibiting* religion. *See* Committee for Public Education v. NyQuist, 413 U.S. 756, 788 (1973). So long as a law avoids "classifications" couched in terms of religion, either to confer a benefit or to impose a burden, the legislation will be in conformity with both religion clauses. I regard Walz v. Tax Commission, 397 U.S. 664 (1974) as standing for the proposition that in order to fulfill the intention of avoiding inhibiting the free exercise of religion by exempting religious organizations from taxes, the statute must be drafted broadly enough so as to not offend the prohibition against establishing a religion.

In *Walz*, the Supreme Court upheld the granting of property tax exemptions to churches *as part of a general exception for a wide variety of nonprofit institutions.* The challenged New York statute exempted not only all religious organizations, but also hospitals, libraries, playgrounds, scientific, professional, historical, and patriotic groups. The breadth of the exemption indicated it had a secular purpose and provided only "incidental" aid to religion. Walz v. Tax Commission, *supra* at 673. As a consequence, *Walz* does not approve granting exemptions for church property where no similar exemptions exists for other social services or nonprofit activities. Such a

preferential exemption would almost certainly constitute a prohibited aid to certain religious entities.

Subsequent U.S. Supreme Court decisions support this view. In Gillette v. United States, 401 U.S. 437, 454 (1971), the court indicated while citing *Walz* that "under the establishment of religion clause of the First Amendment, government 'neutrality' in matters of religion is not inconsistent with 'benevolence' by way of exemptions from onerous duties, *so long as an exemption is tailored broadly enough that it reflects valid secular purposes.*" (emphasis added). Likewise, in Committee for Public Education v. NyQuist, *supra* at 794, the court recalled that the exemption challenged in *Walz* was not restricted to a class composed exclusively or even predominately of religious institutions. Hence, "the narrowness of the benefitted class would be an important factor" in any future challenges of statutory provisions under the established clause. *See also* Forest Hills Early Learning Center, Inc. v. Lukhard, 728 F.2d 230, 242 (4th Cir. 1984); Nowak, Rotunda & Young, Constitutional Law, ch. 19, § II at 1033 n. 14 (2nd ed. 1983).

By interpreting *Walz* as approving only church property tax exemptions incidental to a broader tax exception, *Walz* may thereby be reconciled with other establishment clause cases. For instance, in Board of Education v. Allen, 392 U.S. 236 (1968) and Everson v. Board of Education, 330 U.S. 1 (1947) the class of beneficiaries included *all* school children, those in public as well as those in private schools. In Tilton v. Richardson, 403 U.S. 672 (1971), federal aid was made available to *all* institutions of higher learning. To achieve the requisite neutrality required to

avoid neither "advancing" nor "inhibiting" religion, the Supreme Court has in each of the above examples upheld classifications not couched in terms of religion.

The bottom line is that any tax exemption which is drafted narrowly in terms of religion—more narrow than the New York exemption upheld in *Walz*—offends the establishment clause. Special tax benefits given only to religions cannot be squared with the principle of neutrality, and such laws have the *inevitable effect* and purpose of aiding and advancing only those benefited religious institutions. *See* Committee for Public Education v. Nyquist, *supra* at 793.

In summary, I find that § 151.312 is an unconstitutional infringement of the establishment clause of the First Amendment of the United States Constitution, applicable to the States under the Fourteenth Amendment. Since the protections under the establishment clause have been held to be fundamental, *see* Everson v. Board of Education, *supra*, laws which classify in contravention of those protections must meet strict tests of constitutionality without need to resort to the equal protection clause. Consequently, having found no compelling reasons underpinning § 151.312, I conclude the provision is unconstitutional without resorting to an equal protection analysis.

REMEDY

The Comptroller's Office takes the position that should § 151.312 be declared unconstitutional, the appropriate remedy is to sever § 151.312 from the main taxing provisions. The consequences of this proposed action would be to impose a tax on all religious periodicals.

Support for the Comptroller's argument can be found in Tex. Tax Code Ann. § 101.002 (1982 & Supp. 1986) which incorporates by reference the Code Construction Act. Section 311.032(c) of the Code Construction Act provides:

> In a statute that does not contain a provision for severability or nonseverability, if any provision of the statute or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of the statute *that can be given effect without the invalid provision* or application, and to this end the provisions of the statute are severable. (emphasis added).

Tex. Gov't Code Ann. § 311.032(c) (1985). Hence, based upon § 311.032(c), this Court could sever only § 151.312 without violating the doctrine of separation of powers by imposing a tax.

Despite the technical feasibility of the Comptroller's argument, I find that the remaining taxing scheme absent § 151.312 cannot be given effect consistent with the religion clauses of the First Amendment. The equal taxation treatment suggested by the Comptroller creates a dilemma in applying the Lemon v. Kurtzman, *supra*, three-prong test. Although religious periodicals would be taxed on the same basis as other periodicals, the elimination of the exemption would under the reasoning in *Walz* result in greater entanglement in church affairs. Hence, the purpose and primary effect of the legislation absent § 151.312 would be secular, but the entanglement created in the evaluation of church property, tax foreclosures, and those confrontations which follow the taxing process would contravene the principles in *Walz*.

Had § 151.312 been drafted more broadly, my decision might be different; however, to be consistent with *Walz* and the antagonism inherent in the religion clauses, I find the taxing provision must be struck as applied to all periodicals. I would therefore overrule both points of error brought by the Comptroller and affirm the district court's judgment.

/s/ Jimmy Carroll
Justice

[Before Chief Justice Shannon, Justices Brady and Carroll]

Filed: May 27, 1987

[Publish]

FOOTNOTES

1 Although not mentioned or preserved for our review are the Texas constitutional provisions which would support Texas Monthly's position. The pertinent provisions would be:

> Article I, § 6 Freedom of Worship
>
> All men have a natural and indefeasible right to worship Almighty God according to the dictates of their own consciences. No man shall be compelled to attend, erect or support any place of worship or to maintain any ministry against his consent. No human authority ought, in any case whatever, to control or interfere with the rights of conscience in matters of religion, and no preference shall ever be given by law to any religious society or mode of worship. But it shall be the duty of the Legislature to pass such laws as may be necessary to protect equally every religious denomination in the peaceable enjoyment of its mode of public worship.
>
> Article I, § 7 Appropriations for Sectarian Purposes
>
> No money shall be appropriated, or drawn from the Treasury for the benefit of any sect, or religious society, theological or religious seminary; nor shall property belonging to the state be appropriated for any such purposes.

These sections, when combined, preclude the state from establishing a religion, from aiding a particular religion, from aiding all religions, or from preferring one religion over another. A definite *wall* of separation between church and state is created. In addition, in comparison with the First Amendment of the United States Constitution, Article I, § 6 is more expansive in terms of guaranteeing protection equally of all religions, as well as the right to worship or not to worship, and Article I, § 7 contains a more specific prohibition on establishment.

A basic difference surrounds the Texas Constitution in contrast to the Federal Constitution which favors future reliance on the former. The Texas Bill of Rights is written as an affirmative grant of protections, whereas the federal constitutional language is negatively drafted as a restriction on the powers of government. Where the language of the Texas Constitution differs it is important to reevaluate the issue "to ascertain and give effect to the plain intent and language of the framers and of the people who adopted it." Gregg v. Cayuga Independent School District, 539 S.W.2d 861, 865-66 (Tex.), *appeal dismissed*, 429 U.S. 973 (1976).

There is a presumption that the language used was carefully selected, made to express the will of the people, and that in adopting it the drafters intended to give effect to every one of its provisions. Mellinger v. City of Houston, 3 S.W. 249, 252 (Tex. 1887). Therefore, structural, historical, and comparative analyses are all important. Harrington, The Texas Bill of Rights and Civil Liberties, 18 Tex. Tech. L. Rev. 1487, 1505 (1986).

The Texas constitutional provisions concerning religion, although in part declaratory of the earlier experiences of America, also reflect an immediate experience in religious intolerance suffered by Texas settlers before their independence from Mexico. At the time of the separation, the laws of Mexico made Catholicism the established religion. The Catholic church was therefore supported by governmental taxation of the citizenry as a whole. The Texas Declaration of Independence in 1836, charged that the Republic of Mexico had denied the colonists the right to worship according to the dictates of their consciences through required support of a national religion. The basic tenet of freedom of religion, which among others prompted the Texas

colonists to declare their independence, was carried forward in the language of the first Constitution of the Republic and later state constitutions in order to guard against any future encroachments. *See* Church v. Bullock, 109 S.W. 115, 117 (1908).

The rich Texas historical background consequently suggests specific constitutional protections not afforded by the United States Constitution. The language and early Texas experience clearly denote a stronger belief in the separation of church and state.

APPENDIX B

IN THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

NO. 14,692

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS AND ANN RICHARDS, TREASURER OF THE STATE OF TEXAS,

APPELLANTS

vs.

TEXAS MONTHLY, INC.,

APPELLEE

FROM THE DISTRICT COURT OF TRAVIS COUNTY, 345TH JUDICIAL DISTRICT, NO. 378,384, HONORABLE JOE B. DIBRELL, JR., JUDGE

Appellee, Texas Monthly, Inc., sued the Comptroller of Public Accounts and others in the district court of Travis County seeking recovery of sales taxes paid under protest. After trial to the court, the district court rendered judgment that Texas Monthly recover $149,107.74. This Court will reverse the judgment.

Texas Monthly publishes a general interest magazine on a monthly basis. Effective October 2, 1984, the sales of its magazine became subject to the sales tax. Tex. Tax Code Ann. § 151.051 (Supp. 1982). Texas Monthly paid, under protest $149,107.74 which sum represented the tax on the sale of its magazine between January 21, 1985 and December 18, 1985.

Texas Monthly's suit for refund was predicated upon the fact that certain publications are exempted from payment of the sales tax. Tex. Tax Code Ann. § 151.312. That section provides:

> Periodicals that are published, or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religion or religious faith are exempted from the taxes imposed by this Chapter.

In its trial petition, Texas Mont'ly pleaded that:

> Section 151.312 exempts from the sales tax religious periodicals. Such an exemption constitutes an unlawful discrimination based on the content of a publication and thus violates Plaintiff's rights guaranteed by the First and Fourteenth Amendments to the Constitution of the United States and Article 1, § 8 of the Constitution of Texas.

The district court's judgment declared § 151.312 unconstitutional "because it constitutes an unlawful discrimination based on the content of [Texas Monthly's] publication in violation of its rights under the First and Fourteenth Amendments of the U.S. Constitution and Article VIII § 1 of the Texas Constitution . . . .

Although the trial petition and the judgment are not entirely clear, the Comptroller and Texas Monthly in their briefs and oral argument took the position that the district court's judgment was grounded upon the premise that the § 151.312 exemption violated the equal protection and free speech clauses of the First and Fourteenth Amendments to the Constitution of the United States and the equal and uniform clause of Article VIII § 1 of the Constitution of Texas. In its brief, Texas Monthly dis-

cusses the establishment clause of the First Amendment but only as a part of its equal protection analysis.

Under point of error one, the Comptroller first asserts that the district court erred in concluding that § 151.312 violated the equal protection clause of the United States Constitution and the equal and uniform clause of the Texas Constitution. We agree.

It is inherent in the exercise of the power to tax that a state be free to select the subjects of taxation and to grant exemptions. Equal protection does not impose on a state any rigid equality of taxation. Inequalities which result from singling out one particular class for taxation or exemption infringe no constitutional limitation. Carmichael v. Southern Coal & Coke Co., 301 U.S. 495 (1936). Like considerations govern exemptions from the operation of a tax imposed on the members of a class. The legislature is not bound to tax every member of a class or none at all. The legislature may make rational distinctions of degree having a rational basis. Carmichael v. Southern Coal & Coke Co., *supra;* Hurt v. Cooper, 110 S.W.2d 896 (Tex. 1937); American Transfer & Storage Co. v. Bullock, 525 S.W.2d 918 (Tex. Civ. App. 1975, writ ref'd). The exemptions, when subjected to judicial scrutiny, must be presumed to rest on a rational basis if any state of facts would support such basis. Carmichael v. Southern Coal & Coke Co., *supra.* Indeed, it is said that "the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against persons and classes. The burden is on the one attacking the legislative arrangement to negate every conceivable basis which might support it." Madden v. Kentucky, 309 U.S. 83 (1940).

In its effort to meet this burden, Texas Monthly suggests that the § 151.312 exemption constitutes a law "respecting an establishment of religion," in violation of the United States Constitution,[1] and therefore is unsupported by any legitimate basis.

The United States Supreme Court has created a three-part test to aid in determining whether a statute violates the establishment clause:

> First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion, . . . finally, the statute must not foster "an excessive entanglement with religion."

Lemon v. Kurtzman, 403 U.S. 602, 612-13 (1971). "Each value judgment under the religion clauses must . . . turn on whether particular acts in question are intended to establish or interfere with religious beliefs and practices or have the effect of doing so." Walz v. Tax Commission, 397 U.S. 664, 669 (1970). Applying this criteria, this Court concludes that § 151.312 does not violate the establishment clause. Furthermore, we are of the view that the classification established by this tax exemption has a rational basis and, accordingly, does not deny appellee equal protection of the law.

The secular purpose served by a tax exemption for religious organizations was described in *Walz, supra.* In *Walz* the Supreme Court reasoned that such a tax exemption "restricts the fiscal relationship between church and

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[1] United States Const. amend. I states in part: "Congress shall make no law respecting an establishment of religion . . . ."

state, and tends to complement and reinforce *the desired separation insulating each from the other.*" *Id.* at 676 (emphasis supplied).

Furthermore, the opinion in *Walz* demonstrates that the tax exemption at issue does not have the primary effect of advancing or inhibiting religion. To the contrary, the effect of religious tax exemptions such as § 151.312 is to permit religious organizations to be independent of government support or sanction. Although *Walz* recognized that "[g]ranting tax exemptions to churches necessarily operates to afford [them] an indirect economic benefit," the Court concluded that

> [t]he grant of a tax exemption is not sponsorship since the government does not transfer part of its revenue to churches but simply abstains from demanding that the church support the state. No one has ever suggested that tax exemption has converted libraries, art galleries, or hospitals into the arms of the state . . . .

Id. at 674-75.

Nor does the fact that *Walz* involved an exemption granted to other "nonprofit, quasi-public corporations," as well as to religious groups, distinguish it from this appeal. Although the broader based exemption in *Walz* provided a clearer case of non-sponsorship than is here present, the *neutrality* toward religion effected by the grant of an exemption for religious periodicals is just as evident. To discover an advancement of religion in this statutory scheme is to turn the intent and effect of § 151.312 on its head.

Finally, this Court concludes that § 151.312 does not excessively entangle the state in religious activities and,

accordingly, the statute meets the third prong of the *Lemon v. Kurtzman* test. Once again, we refer to *Walz* as authority for our view. In *Walz* the Court noted that, generally, the grant of an exemption to religious organizations leads to lesser involvement by the State than does taxation. Nevertheless, "[i]n analyzing either alternative the questions are whether the involvement is excessive, and whether it is a continuing one calling for official and continuing surveillance leading to an impermissible degree of entanglement." *Id.* at 675. This analysis involves examination of "the character and purposes of the institutions that are benefitted, the nature of the aid that the State provides, and the resulting relationship beween the government and the religious authority." *Lemon, supra* at 615.

To the extent § 151.312 creates entanglement, it creates entanglement between government and institutions with purely religious purposes. We are not faced, therefore, with the difficulties presented when the government attempts to limit its intrusion to the secular endeavors of a religious organization—for example, where government attempts to provide aid for the non-religious curriculum of sectarian schools and yet creates excessive entanglement by oversight measures intended to insure that the aid is not directed to religious purposes. *See Lemon, supra;* Meek v. Pittenger, 421 U.S. 349, 372 (1975). Accordingly, our focus is on the nature of the State's aid and the relationship between the State and religious publishers that results from the aid.

The aid at issue is, of course, the indirect subsidy provided by the tax exemption to religious periodicals. No

affirmative action by state government is necessary to bestow this benefit. Due to its passive nature, the tax exemption does not create the appearance of an ongoing partnership between the State and religion presented by direct aid. More important, the exemption is administered in such a manner that "official and continuing surveillance" by the government is avoided.

Wanda Hutcheson, supervisor for sales tax policy in the Comptroller's Office, testified that religious publishers may qualify for an exemption by making a one-time showing that they are a bona fide religious organization under Texas Tax Code § 151.310. Hutcheson further testified that "we leave it to [the organization] to decide whether or not it's . . . a publication that teaches their faith."

The Comptroller's application of § 151.312 in no manner resembles the "comprehensive, discriminating, and continuing state surveillance" which confronted the Supreme Court in *Lemon*. *Id.* at 619. In *Lemon*, the State had conditioned its direct aid to nonpublic schools with "pervasive" restrictions and a continuing right to inspect and audit school records. In contrast, our record demonstrates that the exemption is administered with a minimum of church-state entanglement and with an eye toward the goal of state neutrality codified in § 151.312 and elaborated in *Walz*.

Because the record in this appeal reveals "no realistic likelihood" that § 151.312 is enforced in such a way as to allow impermissible entanglement, this Court concludes that the Comptroller has met the third prong of the *Lemon* test. *See* Hunt v. McNair, 413 U.S. 734, 747-78

(1973) (statute was constitutional where administrative scheme negated possibility that breadth of statute would lead to excessive entanglement).

The policy of neutrality toward religion embodied in § 151.312 provides a rational basis for the exemption and defeats any claim that the exemption violates the establishment clause. Accordingly, we conclude that § 151.312 does not deny appellee equal protection of the laws.

Also under its first point of error, the Comptroller asserts that the district court erred in concluding that the § 151.312 exemption violated the free speech clause of the First Amendment. We agree.

This issue is controlled by the holding of the United States Supreme Court in Regan v. Taxation with Representation of Washington, 461 U.S. 540 (1983). *Regan* involved the validity of Internal Revenue Code Provisions which allowed contributions to tax exempt organizations to be tax deductible only if the organization did not engage in lobbying. Taxation With Representation claimed the denial of this tax benefit was an "unconstitutional condition" on its exercise of free speech through lobbying. The Supreme Court rejected this claim, stating that "[t]his Court has never held that Congress must *grant a benefit* such as [Taxation With Representation] claims here to a person who wishes to exercise a constitutional right." *Id.* at 545 (emphasis supplied). In short, the Supreme Court held that the failure of the State to *subsidize* speech does not significantly interefere with First Amendment rights.

The same logic applies to § 151.312 of the Tax Code. The legislature has chosen to grant a tax benefit to re-

ligious publications. However, Texas Monthly has not shown that the legislature's failure to grant this benefit to other types of publications has "coerced" them into restricting their right of free speech. *Cf.* Speiser v. Randall, 357 U.S. 513 (1958). The first point of error is sustained.

In its prayer for relief, Texas Monthly, of course, asked that this Court affirm the district court's judgment. If, however, this Court concluded that the district court erred respecting § 151.312, Texas Monthly then requested that we remand the cause to district court for its consideration of issues raised but not there determined.

It is true that Texas Monthly pleaded that it was entitled to recovery of the taxes based upon one of several grounds. It is likewise true that the district court predicated its judgment upon only one such ground—the claimed unconstitutionality of § 151.312. Texas Monthly, however, did not complain in district court of the court's failure to consider and pass on its other asserted grounds of recovery, nor did it assert any such complaints by cross-points in this Court. Accordingly, Texas Monthly waived any right it may have had to require the district court to consider and pass on its other ground of recovery. State Bar of Texas, Appellate Procedure in Texas § 15.16 at 351 (2nd ed. 1979).

The judgment of the district court is reversed and judgment is here rendered that Texas Monthly take nothing.

/s/ Bob Shannon
Chief Justice

[Before Chief Justice Shannon, Justices Brady and Carroll]

Reversed and Rendered

Filed: March 18, 1987

[Publish]

IN THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

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APPELLEE

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I respectfully dissent. I am particularly troubled by the impermissible intrusion of the State into religious affairs mandated by the *express terms* of § 151.312. Before allowing an exemption under § 151.312, the Comptroller must not only determine whether a bona fide "religious faith" is distributing the periodical, he must also assess whether the publication consists "wholly" of writings promulgating the teachings of the "religious faith."

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I find § 151.312 unconstitutional under the establishment clause of the First Amendment for two basic reasons.[1] First, and foremost, the exemption engenders impermissible state entanglement with religion. Second, as written, § 151.312 has a constitutionally prohibited primary effect of advancing religion.

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The language in the Bill of Rights was not drafted on the assumption that government will exercise power properly, but against the possible reality that the power to rule may be abused. The First Amendment does not simply prohibit the establishment of a state church or a state religion, instead it commands that there should be "no law *respecting* an establishment of religion." A given law might not *establish* a state religion but it may nevertheless be one "respecting" that end in the sense of being a step that could lead to such establishment and hence offend the First Amendment. Lemon v. Kurtzman, 403 U.S. 602, 612 (1971). The "perception" that government is aiding

religion is enough to strike a law as violating the establishment clause. *Cf.* Grand Rapids School Dist. v. Ball, 105 S.Ct. 3216, 3226 (1985). No ongoing partnership needs to be shown.

PRIMARY EFFECT

Inherent in the First Amendment is an antagonism between the command not to establish a religion and the command not to inhibit its practice. Either religion clause if expanded to its logical extreme would tend to clash with the other. As a result of this tension, state actions must maintain an attitude of "neutrality," neither *advancing* nor *inhibiting* religion. *See* Committee for Public Education v. NyQuist, 413 U.S. 756, 788 (1973). So long as a law avoids "classifications" couched in terms of religion, either to confer a benefit or to impose a burden, the legislation will be in conformity with both religion clauses. I regard Walz v. Tax Commission, 397 U.S. 664 (1974) as standing for the proposition that in order to fulfill the intention of avoiding inhibiting the free exercise of religion by exempting religious organizations from taxes, the statute must be drafted broadly enough so as to not offend the prohibition against establishing a religion.

In *Walz*, the Supreme Court upheld the granting of property tax exemptions to churches *as part of a general exception for a wide variety of nonprofit institutions.* The challenged New York statute exempted not only all religious organizations, but also hospitals, libraries, playgrounds, scientific, professional, historical, and patriotic groups. The breadth of the exemption indicated it had a secular purpose and provided only "incidental" aid to

religion. Walz v. Tax Commission, *supra* at 673. As a consequence, *Walz* does not approve granting exemptions for church property where no similar exemptions exists for other social services or nonprofit activities. Such a preferential exemption would almost certainly constitute a prohibited aid to certain religious entities.

Subsequent U.S. Supreme Court decisions support this view. In Gillette v. United States, 401 U.S. 437, 454 (1971), the court indicated while citing *Walz* that "under the establishment of religion clause of the First Amendment, government 'neutrality' in matters of religion is not inconsistent with 'benevolence' by way of exemptions from onerous duties, *so long as an exemption is tailored broadly enough that it reflects valid secular purposes.*" (emphasis added). Likewise, in Committee for Public Education v. NyQuist, *supra* at 794, the court recalled that the exemption challenged in *Walz* was not restricted to a class composed exclusively or even predominately of religious institutions. Hence, "the narrowness of the benefitted class would be an important factor" in any future challenges of statutory provisions under the established clause. *See also* Forest Hills Early Learning Center, Inc. v. Lukhard, 728 F.2d 230, 242 (4th Cir. 1984); Nowak, Rotunda & Young, Constitutional Law, ch. 19, § II at 1033 n. 14 (2nd ed. 1983).

By interpreting *Walz* as approving only church property tax exemptions incidental to a broader tax exception, *Walz* may thereby be reconciled with other establishment clause cases. For instance, in Board of Education v. Allen, 392 U.S. 236 (1968) and Everson v. Board of Education, 330 U.S. 1 (1947) the class of beneficiaries included

all school children, those in public as well as those in private schools. In Tilton v. Richardson, 403 U.S. 672 (1971), federal aid was made available to *all* institutions of higher learning. To achieve the requisite neutrality required to avoid neither "advancing" nor "inhibiting" religion, the Supreme Court has in each of the above examples upheld classifications not couched in terms of religion.

The bottom line is that any tax exemption which is drafted narrowly in terms of religion—more narrow than the New York exemption upheld in *Walz*—offends the establishment clause. Special tax benefits given only to religions cannot be squared with the principle of neutrality, and such laws have the *inevitable effect* and purpose of aiding and advancing only those benefited religious institutions. *See* Committee for Public Education v. Nyquist, *supra* at 793.

In summary, I find that § 151.312 is an unconstitutional infringement of the establishment clause of the First Amendment of the United States Constitution, applicable to the States under the Fourteenth Amendment. Since the protections under the establishment clause have been held to be fundamental, *see* Everson v. Board of Education, *supra*, laws which classify in contravention of those protections must meet strict tests of constitutionality without need to resort to the equal protection clause. Consequently, having found no compelling reasons underpinning § 151.312, I conclude the provision is unconstitutional without resorting to an equal protection analysis.

REMEDY

The Comptroller's Office takes the position that should § 151.312 be declared unconstitutional, the appropriate

remedy is to sever § 151.312 from the main taxing provisions. The consequences of this proposed action would be to impose a tax on all religious periodicals.

Support for the Comptroller's argument can be found in Tex. Tax Code Ann. § 101.002 (1982 & Supp. 1986) which incorporates by reference the Code Construction Act. Section 311.032(c) of the Code Construction Act provides:

> In a statute that does not contain a provision for severability or nonseverability, if any provision of the statute or its application to any person or circumstance is held invalid, the invalidity does not effect other provisions or applications of the statute *that can be given effect without the invalid provision* or application, and to this end the provisions of the statute are severable. (emphasis added).

Tex. Gov.'t Code Ann. § 311.032(c) (1985). Hence, based upon § 311.032(c), this Court could sever only § 151.312 without violating the doctrine of separation of powers by imposing a tax.

Despite the technical feasibility of the Comptroller's argument, I find that the remaining taxing scheme absent § 151.312 cannot be given effect consistent with the religion clauses of the First Amendment. The equal taxation treatment suggested by the Comptroller creates a dilemma in applying the Lemon v. Kurtzman, *supra*, three-prong test. Although religious periodicals would be taxed on the same basis as other periodicals, the elimination of the exemption would under the reasoning in *Walz* result in greater entanglement in church affairs. Hence, the purpose and primary effect of the legislation absent § 151.312 would be secular, but the entanglement created in the evaluation of

church property, tax foreclosures, and those confrontations which follow the taxing process would contravene the principles in Walz.

Had §151.312 been drafted more broadly, my decision might be different; however, to be consistent with *Walz* and the antagonism inherent in the religion clauses, I find the taxing provision must be struck as applied to all periodicals. I would therefore overrule both points of error brought by the Comptroller and affirm the district court's judgment.

Jimmy Carroll, Justice

[Before Chief Justice Shannon, Justices Brady and Carroll]
Filed: March 18, 1987
[Publish]

FOOTNOTES

[1] Although not mentioned or preserved for our review are the Texas constitutional provisions which would support Texas Monthly's position. The pertinent provisions would be:

> Article I, § 6 Freedom of Worship
>
> All men have a natural and indefeasible right to worship Almighty God according to the dictates of their own consciences. No man shall be compelled to attend, erect or support any place of worship or to maintain any ministry against his consent. No human authority ought, in any case whatever, to control or interfere with the rights of conscience in matters of religion, and no preference shall ever be given by law to any religious society or mode of worship. But it shall be the duty of the Legislature to pass such laws as may be necessary to protect equally every religious denomination in the peaceable enjoyment of its mode of public worship.
>
> Article I, § 7 Appropriations for Sectarian Purposes
>
> No money shall be appropriated, or drawn from the Treasury for the benefit of any sect, or religious society,

(Continued on next page)

(Continued from previous page)

theological or religious seminary; nor shall property belonging to the state be appropriated for any such purposes.

These sections, when combined, preclude the state from establishing a religion, from aiding a particular religion, from aiding all religions, or from preferring one religion over another. A definite *wall* of separation between church and state is created. In addition, in comparison with the First Amendment of the United States Constitution, Article I, § 6 is more expansive in terms of guaranteeing protection equally of all religions, as well as the right to worship or not to worship, and Article I, § 7 contains a more specific prohibition on establishment.

A basic difference surrounds the Texas Constitution in contrast to the Federal Constitution which favors future reliance on the former. The Texas Bill of Rights is written as an affirmative grant of protections, whereas the federal constitutional language is negatively drafted as a restriction on the powers of government. Where the language of the Texas Constitution differs it is important to reevaluate the issue "to ascertain and give effect to the plain intent and language of the framers and of the people who adopted it." Gregg v. Cayuga Independent School District, 539 S.W.2d 861, 865-66 (Tex.), *appeal dismissed*, 429 U.S. 973 (1976).

There is a presumption that the language used was carefully selected, made to express the will of the people, and that in adopting it the drafters intended to give effect to every one of its provisions. Mellinger v. City of Houston, 3 S.W. 249, 252 (Tex. 1887). Therefore, structural, historical, and comparative analyses are all important. Harrington, The Texas Bill of Rights and Civil Liberties, 18 Tex. Tech. L. Rev. 1487, 1505 (1986).

The Texas constitutional provisions concerning religion, although in part declaratory of the earlier experiences of America, also reflect an immediate experience in religious intolerance suffered by Texas settlers before their independence from Mexico. At the time of the separation, the laws of Mexico made Catholicism the established religion. The Catholic church was therefore supported by governmental taxation of the citizenry as a whole. The Texas Declaration of Independence in 1836, charged that the Republic of Mexico had denied the colonists the right to worship according to the dictates of their consciences through required sup-

(Continued on next page)

(Continued from previous page)

port of a national religion. The basic tenet of freedom of religion, which among others prompted the Texas colonists to declare their independence, was carried forward in the language of the first Constitution of the Republic and later state constitutions in order to guard against any future encroachments. *See* Church v. Bullock, 109 S.W. 115, 117 (1908).

The rich Texas historical background consequently suggests specific constitutional protections not afforded by the United States Constitution. The language and early Texas experience clearly denote a stronger belief in the separation of church and state.

IN THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

JUDGMENT RENDERED MARCH 18, 1987

14,692—BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS AND ANN RICHARDS, TREASURER OF THE STATE OF TEXAS V. TEXAS MONTHLY, INC. APPEAL FROM 345TH DISTRICT COURT OF TRAVIS COUNTY

Before Chief Justice Shannon, Justices Brady and Carroll

REVERSED AND RENDERED—Opinion by Chief Justice Shannon; Dissenting opinion by Justice Carroll

THIS CAUSE came on to be heard on the transcript of the record and same being inspected, because it is the opinion of the Court that there was error in the trial court's judgment: **IT IS THEREFORE** considered, adjudged and ordered that the judgment of the trial court be and is hereby reversed, and judgment be and is hereby rendered that appellee, Texas Monthly, Inc., take nothing. It is **FURTHER** ordered that appellee, Texas Monthly, Inc., pay all costs in this behalf expended both in this Court and the court below and that this decision be certified below for observance.

APPENDIX C

NO. 378,384

TEXAS MONTHLY, INC. Plaintiff	)	IN THE DISTRICT COURT OF TRAVIS
VS.	)	COUNTY, TEXAS
STATE OF TEXAS, BOB BULLOCK COMPTROLLER OF PUBLIC OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS, AND ANN RICHARDS, TREASURER OF THE STATE OF TEXAS Defendants	)	345TH JUDICIAL DISTRICT

FINAL JUDGMENT

BE IT REMEMBERED that on the 3rd and 4th days of February, 1986, the above-styled and numbered cause came on for trial on the merits, all parties having due prior notice of such setting.

The parties announced ready for trial through their respective attorneys of record, whereupon the Court proceeded with the trial of the merits before the Court. After examining the pleadings and considering the evidence, the trial briefs, and arguments of counsel, the Court finds that TEX. TAX CODE ANN. § 151.312 is unconstitutional because it constitutes an unlawful discrimination based on the content of Plaintiff's publication in violation of its rights under the First and Fourteenth Amendments of the U.S. Constitution and Article VIII § 1 of the Texas Con-

stitution, that Plaintiff is entitled to the relief prayed for in its Second Amended Original Petition, that the sum of One Hundred Forty-Nine Thousand One Hundred Seven and 74/100 Dollars ($149,107.74) paid by Plaintiff under protest pursuant to § 112.051, TEX. TAX CODE ANN., belongs to Plaintiff and was unlawfully demanded by Defendants.

It is therefore, ORDERED, ADJUDGED and DECREED that Texas Monthly, Inc. have and recover from the State of Texas the sum of One Hundred Forty-Nine Thousand One Hundred Seven and 74/100 Dollars ($149,107.74), plus interest as provided in § 112.058, TEX. TAX CODE ANN., from the date such sum was paid under protest until refunded.

It is further ORDERED, ADJUDGED and DECREED that it is the duty of the State Treasurer of Texas to refund such sum of One Hundred Forty-Nine Thousand One Hundred Seven and 74/100 Dollars ($149, 107.74), together with the pro-rata interest earned thereon, to Texas Monthly, Inc. by the issuance of refund warrants to be written and signed by the Comptroller of Public Accounts of the State of Texas and counter-signed by the Treasurer of the State of Texas, and charged against the suspense account as provided in § 112.060, TEX. TAX CODE ANN., such warrants to be delivered by the Comptroller of Public Accounts to Plaintiff, and Defendants are accordingly ORDERED to take all such action as is necessary and appropriate to accomplish such refund and the issuance and delivery of such refund warrants to Texas Monthly, Inc. in compliance with this judgment.

It is further ORDERED, ADJUDGED and DECREED that all costs of Court are adjudged against Defendants herein. All writs and processes for the enforcement and collection of this judgment or the costs of Court may issue as necessary.

Since the Court has concluded that because the legislature has exempted periodicals described in Section 151.312 from the tax and not exempted Plaintiff's periodical, collection of the tax from Plaintiff violated the Constitutions of the United States and Texas. It is therefore unnecessary for it to make findings of facts and conclusions of law on the other issues raised by Plaintiff's pleadings and none are made.

SIGNED this 12th day of February, 1986.

/s/ Joe B. Dibrell, Jr.
JUDGE PRESIDING

APPROVED AS TO FORM ONLY:

GRAVES, DOUGHERTY, HEARON & MOODY
2300 InterFirst Tower
P.O. Box 98
Austin, Texas 78767
512/480-5600

By: /s/ R. James George, Jr.
State Bar ID #07810000

ATTORNEYS FOR PLAINTIFF

JIM MATTOX,
Attorney General of Texas

MARY KELLER,
Executive Assistant

HARRIET D. BURKE,
Assistant Attorney General,
Chief, Taxation Division
P.O. Box 12548
Austin, Texas 78711
512/475-1013

By: /s/ David Mendez
State Bar ID #13932575

ATTORNEYS FOR DEFENDANTS

APPENDIX D

NO. 378,384

TEXAS MONTHLY, INC.,	)	IN THE
	)	DISTRICT
Plaintiff,	)	COURT OF
	)	TRAVIS
	)	COUNTY,
VS.	)	TEXAS
	)	
STATE OF TEXAS, BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS, ET AL,	)	
	)	
	)	345TH
	)	JUDICIAL
	)	DISTRICT
Defendants.	)	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

BE IT REMEMBERED that on the 12th day of February, 1986, judgment was rendered in the above-styled and numbered action for Plaintiff. On February 18, 1986, Defendants filed Request for Findings of Fact and Conclusions of Law, and on the 21st day of March, 1986, filed a Reminder to File Findings of Fact and Conclusions of Law. The Court therefore makes the following Findings of Fact:

FINDINGS OF FACT

1. There are periodicals that qualify under the language in Section 151.312, Texas Tax Code, as religious publications which are regularly circulated in Texas and which would be subject to the sales and use tax but for the application of Section 151.312.

2. There is no basis for the exemption of such religious periodicals other than the promotion of religion itself, a prohibited reason.

3. The determination of which periodical meets the test set out in Section 151.312 requires an analysis of the contents of the writing itself and no decision can be made under the statutory language except by an analysis of the writing.

CONCLUSIONS OF LAW

1. The exemption of religious periodicals pursuant to Section 151.312 of the Texas Tax Code violates the First and Fourteenth Amendments of the Constitution of the United States and Article I, § 8 of the Constitution of Texas.

2. This Court is without power to rewrite the statute to make religious periodicals subject to tax and therefore its only remedy is to prevent the collection of taxes from other peridocals until the legislature determines that religious periodicals described in Section 151.312 should be subject to the same tax.

ENTERED this 11 day of April, 1986.

/s/ Joe B. Dibrell, Jr.,
HONORABLE JOE B. DIBRELL,
JR., JUDGE PRESIDING

APPENDIX E

(SEAL)

COURT OF APPEALS.

Third Supreme Judicial District.

P.O. Box 12547, Capitol Station, Austin, Texas 78711
(512) 463-1733

May 27, 1987

Bob Shannon, Chief Justice
John Powers, Justice
Jim Brady, Justice
Bob Gammage, Justice
Jimmy Carroll, Justice
Marilyn Aboussie, Justice

Susan K. Bage, Clerk

Patrick Shannon
Chief Staff Attorney

Honorable Jim Mattox
Attorney General

Honorable Harriet D. Burke
Assistant Attorney General
P. O. Box 12548, Capitol Station
Austin, Texas 78711

Mr. R. James George, Jr.
Graves, Dougherty, Hearon & Moody
P. O. Box 98
Austin, Texas 78767

Re: No. 14,692—Bob Bullock, Comptroller of Public Accounts of The State of Texas, Jim Mattox, Attorney General of The State of Texas and Ann Richards, Treasurer of The State of Texas v. Texas Monthly, Inc.

Counsel:

Please be advised that appellee's motion for rehearing in the above cause was this day submitted and overruled; former opinion withdrawn and reversed and rendered on motion for rehearing—written opinion.

A copy of this Court's opinion, along with the dissenting opinion by Justice Carroll, are enclosed, in accordance with Rule 91, Tex. R. App. P.

Very truly yours,

SUSAN K. BAGE, CLERK

By: /s/ Ora Aranda
Ora Aranda, Deputy

Encl.

xc: Honorable Joe B. Dibrell, District Judge
Mr. John Dickson, District Clerk

APPENDIX F

(SEAL)

OFFICIAL NOTICE FROM
THIRD COURT OF APPEALS

RE: No. 14,692—Bob Bullock, Comptroller
of Public Accounts of the State of
Texas, et al. v. Texas Monthly, Inc.

May 6, 1987

You are hereby notified that appellee's motion for rehearing en banc was this day submitted and overruled.

Susan K. Bage, Clerk

Third Court of Appeals
P.O. Box 12547
Austin, Texas 78711

Mail to: Mr. R. James George, Jr.
Graves, Dougherty, Hearon & Moody
2300 InterFirst Tower
P. O. Box 98
Austin, Texas 78767

APPENDIX G

(SEAL)

OFFICIAL NOTICE FROM THIRD COURT OF APPEALS

RE: No. 14,692—Bob Bullock
Comptroller of Public Accounts of the
State of Texas, et al. v. Texas Monthly, Inc.

June 24, 1987

You are hereby notified that appellee's second motion for rehearing was this day submitted and overruled.

Susan K. Bage, Clerk

Third Court of Appeals
P.O. Box 12547
Austin, Texas 78711

Mail to: Mr. R. James George, Jr.
Graves, Dougherty, Hearon & Moody
2300 InterFirst Tower
P. O. Box 98
Austin, Texas 78767

APPENDIX H

SUPREME COURT OF TEXAS
P.O. Box 12248
Supreme Court Building
Austin, Texas 78711
Mary M. Wakefield, Clerk

September 23, 1987

Mr. R. James George, Jr.
Graves, Dougherty, Hearon & Moody
P. O. Box 98
Austin, TX 78767

Ms. Harriet D. Burke
Office of the Attorney General of Texas
Jim Mattox, A. G.
P. O. Box 12548 Capitol Station
Austin, TX 78711

Re: Case No. C-6650

STYLE: TEXAS MONTHLY, INC.
v. BOB BULLOCK, COMPTROLLER OF
PUBLIC ACCOUNTS OF THE STATE OF

Dear Counsel:

Today, the Supreme Court of Texas refused the above referenced application for writ of error with the notation, No Reversible Error.

Respectfully yours,

Mary M. Wakefield, Clerk

By: /s/ Blanca E. Morin
Deputy

APPENDIX I

SUPREME COURT OF TEXAS
P.O. Box 12248
Supreme Court Building
Austin, Texas 78711
Mary M. Wakefield, Clerk

October 28, 1987

Mr. R. James George, Jr.
Graves, Dougherty, Hearon & Moody
2300 InterFirst Tower
Austin TX 78701

Ms. Pamela Stanton Baron
Graves, Dougherty, Hearon & Moody
2300 InterFirst Tower
Austin TX 78701

Ms. Harriet D. Burke
Office of the Attorney General of Texas
Jim Mattox, A. G.
P.O. Box 12548 Capitol Station
Austin TX 78711

RE: Case No. C-6650

STYLE: TEXAS MONTHLY, INC. v. BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF

Dear Counsel:

Today, the Supreme Court of Texas overruled petitioner's motion for rehearing of the application for writ of error in the above styled case.

Respectfully yours,

Mary M. Wakefield, Clerk

By: /s/ Blanca E. Morin
Deputy

APPENDIX J

No. 14,692

IN THE COURT OF APPEALS FOR THE
THIRD SUPREME JUDICIAL DISTRICT
AT AUSTIN, TEXAS

BOB BULLOCK, COMPTROLLER OF PUBLIC
ACCOUNTS OF THE STATE OF TEXAS, ET AL.,

Appellants,

vs.

TEXAS MONTHLY, INC.,

Appellee.

Appeal from the 345th Judicial District Court of
Travis County, Texas

NOTICE OF APPEAL
TO THE
SUPREME COURT OF THE UNITED STATES

TO THE HONORABLE COURT OF APPEALS:

Notice is hereby given that Texas Monthly, Inc. hereby appeals to the Supreme Court of the United States from the final judgment on motion for rehearing of this Court of May 27, 1987, reversing the judgment of the district court and upholding, against constitutional challange, the state sales tax imposed on sales of a general interest magazine published by Texas Monthly. The Supreme Court of Texas refused, no reversible error, Texas Monthly's application for writ of error on September 23, 1987 and overruled Texas Monthly's motion for rehearing on application for writ of error on October 28, 1987.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Date: December 3, 1987.

Respectfully submitted,
Graves, Dougherty, Hearon & Moody
2300 InterFirst Tower
Austin, Texas 78701
512/480-5600

By: /s/ R. James George, Jr.
SBN 07810000
John M. Harmon
SBN 09020775
Pamela Stanton Baron
SBN 01797100

Attorneys for Texas Monthly, Inc.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing Notice of Appeal was served on Jim Mattox, Mary Keller and Harriet D. Burke, Attorneys for Bob Bullock, Comptroller of Public Accounts of the State of Texas, Jim Mattox, Attorney General of Texas, and Ann Richards, Treasurer of the State of Texas, at 210 Barton Springs Road, 4th Floor Jamail Building, Austin, Texas, by hand delivery this 3rd day of December, 1987.

It is further certified that all parties required to be served have been served, and that the list of such parties is as set forth above.

/s/ R. James George, Jr.
Attorney for Texas Monthly, Inc.

Graves, Dougherty, Hearon & Moody
2300 FirstRepublic Bank Tower
Austin, Texas 78701
512/480-5600

APPENDIX K

§ 151.312. *Religious Periodicals and Writings*

Periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religious faith are exempted from the taxes imposed by this chapter.

APPENDIX L

§ 151.310. *Religious, Educational, and Public Service Organizations*

(a) A taxable item sold, leased, or rented to, or stored, used, or consumed by, any of the following organizations is exempted from the taxes imposed by this chapter:

(1) an organization created for religious, educational, or charitable purposes if no part of the net earnings of the organization benefits a private shareholder or individual and the items purchased are related to the purpose of the organization;

(2) an organization qualifying for an exemption from federal income taxes under Section 501(c)(3), (4), (8), (10), or (19), Internal Revenue Code, of the item sold, leased, rented, stored, used, or consumed relates to the purpose of the exempted organization and the item is not used for the personal benefit of a private stockholder or individual;

(3) a nonprofit organization engaged exclusively in providing athletic competition among persons under 19 years old if no financial benefit goes to an individual or shareholder;

(4) a company, department, or association organized for the purpose of answering fire alarms and extinguishing fires or for the purpose of answering fire alarms, extinguishing fires, and providing emergency medical services, the members of which receive no compensation or only nominal compensation for their services rendered, if the taxable item is used exclusively by the company, department, or association; or

(5) a chamber of commerce or a convention and tourist promotional agency representing at least one Texas city or county if the chamber of commerce or the agency is not organized for profit and no part

of its net earnings inures to a private shareholder or other individual.

(b) The sale of, or contracting for the sale of, concessions at an event conducted by an organization exempted under Subsection (a)(3) of this section does not prevent the application of the exemption to that organization.

(c) An organization that qualifies for an exemption under Subsection (a)(1) of this section may hold one tax-free sale or auction during a calendar year and the tax-free sale or auction may continue for one day only. The sale of a taxable item by a qualified organization at a tax-free sale or auction is exempted from the sales tax imposed by Subchapter C of this chapter. The storage, use, or consumption of a taxable item acquired from a qualified organization at a tax-free sale or auction is exempted from the use tax imposed by Subchapter D of this chapter until the item is resold or subsequently transferred.

(d) If two or more organizations jointly hold a tax-free sale or auction, neither organization may hold another tax-free sale or auction during the calendar year. The employment of and payment of a reasonable fee to an auctioneer to conduct a tax-free auction does not disqualify an otherwise qualified organization from receiving the exemption provided by Subsection (c) of this section.

APPENDIX M

34 Tex. Admin. Code § 3.299(d) provides:

> *Sacred writings.* The receipts from the sale or use in this state of books consisting wholly of writings sacred to any religious faith, and religious periodicals published or distributed by any religious faith consisting wholly of writings promulgating the teaching of such faith, or audio-electronic transcriptions of this material, are exempt from the sales tax. The exemption for publications and books sacred to a particular faith does not extend to sheet music and films.

(2)

Supreme Court, U.S.
FILED
FEB 19 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-1245

In The
SUPREME COURT OF THE UNITED STATES
October Term, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

MOTION TO DISMISS OR AFFIRM

JIM MATTOX
Attorney General of Texas

MARY F. KELLER
First Assistant Attorney General

LOU McCREARY
Special Assistant Attorney General

HARRIET D. BURKE*
Assistant Attorney General
Chief, Taxation Division
P.O. Box 12548
Austin, Texas 78711-2548
(512) 463-2002

February 19, 1988
Attorney of Record

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NO. 87-1245

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS,
THIRD SUPREME JUDICIAL DISTRICT
OF TEXAS, AT AUSTIN

MOTION TO DISMISS OR AFFIRM

Appellees, Bob Bullock, Comptroller of Public Accounts of the State of Texas, Jim Mattox, Attorney General of the State of Texas, and Ann Richards, Treasurer of the State of Texas, move the Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Texas Court of Appeals, on appeal pursuant to 28 U.S.C. Section 1257(2) on the grounds that the questions presented are so unsubstantial as not to need further argument.

STATEMENT OF THE CASE

Appellant has appealed from a decision of a state court, the Court of Appeals, Third Supreme Judicial District, Austin, Texas, holding that Section 151.312 of the Texas Tax Code does not violate the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution and the Free Press, Free Speech and Establishment Clauses of the First Amendment to the United States Constitution.

Section 151.312, Texas Tax Code, an exemption provision appearing in the Texas Sales and Use Tax Act, provides:

> Periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religious faith are exempted from the taxes imposed by this chapter.

There is no dispute that Appellant publishes a general interest magazine, *Texas Monthly*, on a monthly basis. Appellant paid taxes under protest pursuant to Section 112.051, Texas Tax Code, which permits a taxpayer to pay taxes to the agency charged with collecting them and then to sue to recover them. Appellant was not audited by Appellee Comptroller. The taxes in issue total $149,107.74 and were paid from February 20, 1985 through December 18, 1985. The amount represents tax due on Appellant's subscription sales of magazines.

Before October 2, 1984, subscription sales of magazines that were sold for a semiannual or longer period and were entered as second class mail were

exempt from the application of the Texas sales and use tax. Section 151.320, Texas Tax Code. Effective October 2, 1984, the exemption for these sales was repealed and they became subject to the sales and use tax. Sales of magazines from a newstand were subject to tax, both before and after October 2, 1984.

Effective October 1, 1987, the exemption for magazines appearing in Section 151.320 was re-enacted. Between October 2, 1984 and September 30, 1987, the only exemption for magazines, which were sold, appeared in Section 151.312, the religious periodical exemption. From October 2, 1984 through September 30, 1987 all sales of magazines were taxable under the Texas sales and use tax except for sales of religious periodicals.

The Texas sales and use tax was during the time period in issue imposed on all sellers of tangible personal property including magazine publishers. "A tax is imposed on each sale of a taxable item in this State." Texas Tax Code Section 151.051(a). "Taxable item" is defined as "tangible personal property." Texas Tax Code Section 151.010. "Tangible personal property" is "personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner." Texas Tax Code Section 151.009. Under Texas Tax Code Section 151.054(a), "All gross receipts of a seller are presumed to have been subject to the sales tax unless a properly completed resale or exemption certificate is accepted by the seller."

QUESTIONS PRESENTED

1. Whether a state statute exempting from a general sales tax only those "periodicals that are published or distributed by a religious faith and that

consist wholly of writings promulgating the teaching of the faith" unconstitutionally discriminates in the taxation of periodicals based on content under this Court's decision in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S.Ct. 1722 (1987).

2. Whether a state statute exempting from a general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith" is invalid as violative of the Establishment Clause of the First Amendment.

THE QUESTIONS PRESENTED ARE NOT SUBSTANTIAL

I. Section 151.312, Texas Tax Code, does not violate the Equal Protection Clause of the Fourteenth Amendment and the Free Press and Free Speech Clauses of the First Amendment. The Texas sales tax scheme does not unconstitutionally discriminate between periodicals based on content.

The Texas tax scheme does not offend the First and Fourteenth Amendments and does not conflict with recent decisions of this Court.

Arkansas Writers' Project Inc. v. Ragland, 107 S.Ct. 1722 (1987) and *Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, 460 U.S. 575 (1983), relied on by Appellant to support its argument of content based discrimination, deal with tax systems substantially different from the Texas system. In *Arkansas Writers' Project*, religious, professional, trade and sports journals and/or publications printed and published within the State and sold through regular

subscription were exempted from the Arkansas sales and use tax act. General interest publications were not exempt. *Arkansas Writers' Project,* a general interest publication, was one of only one or two Arkansas publications paying the tax. The court noted "the burden of the tax clearly falls on a limited group of publishers." 107 S.Ct. at 1727.

The *Minneapolis Star* tax scheme also does not resemble the Texas tax structure. Minnesota exempted the sale of newspapers and other publications but imposed a special use tax on the cost of paper and ink products consumed in the production of a publication. The first $100,000 of such purchases was exempted. The effect of this statute was that in 1974 and 1975, 11 publishers and 13 publishers, respectively, paid the tax. The *Star Tribune* was one of the 11 and 13 publishers paying the tax. In both years, the *Star Tribune* paid two-thirds of the total revenue raised by the tax. This Court determined that by creating the special use tax Minnesota had singled out the press for special treatment and had violated the Free Press Clause of the First Amendment. The tax was being paid only by the press and only by a small group of the press. "Minnesota's ink and paper tax violates the First Amendment not only because it singles out the press, but also because it targets a small group of newspapers." 460 U.S. at 591. This tax scheme does not resemble the Texas tax structure.

Unlike *Arkansas Writers' Project* where a very small group of magazines were singled out for taxation, and *Minneapolis Star* where the tax was being paid only by the press and only by a small group of the press, the Texas system subjects all publishers to tax, except publishers of religious publications.

For content discrimination to apply to a tax provision, the press must be singled out or a small group of the press must be targeted. There is no selective content based exemption or taxation of certain magazines by taxing all types of magazines and exempting one type.

Appellant should pay the same tax that all other sellers of tangible personal property must pay to Texas. "It is not intended by anything we have said to suggest that the owners of newspapers are immune from any of the ordinary forms of taxation for support of the government." *Grosjean v. American Press Co.*, 297 U.S. 233, 250 (1936). See also *Arcara v. Cloud Books Inc.*, 106 S.Ct. 3172, 3177 (1986).

Texas does not have to prove its statutory provision is necessary to serve a "compelling state interest" and that it "is narrowly drawn to achieve that end." *Arcara v. Cloud Books* Inc., 106 S.Ct. at 3177 and 3178. The statute in question is an exemption provision. The Court of Appeals correctly placed the burden on Appellant of negating every conceivable basis which might support it. *Madden v. Kentucky*, 309 U.S. 83, 88 (1940). Legitimate state purposes supporting the provision are to prevent an excessive entanglement with religion and/or to reinforce the desired separation of church and state. Appellant does not seek to have this Court review the case on a rational basis standard.

Appellees do not understand how Appellant would be benefited by this Court assuming jurisdiction. Appellant attacks the exemption and not the tax. Unlike *Minneapolis Star*, where the Court invalidated the use tax and the taxpayer recovered the tax, or *Arkansas Writers Project* where the Court also invalidated the whole tax and the taxpayer recovered the

tax, the only issue to be addressed in this case is the validity of the exemption in Texas Tax Code Section 151.312. If Section 151.312 were invalidated, this Section would fall. There is no basis for invalidating the tax because the tax is a non-discriminatory tax on all magazine sellers. The result of Appellant's argument would be that religious periodicals would become subject to taxation. Appellant would still be responsible for the tax it paid to the State of Texas and could not recover the amount it paid under protest. Appellant has presented no substantial federal question and the Supreme Court should not take jurisdiction of the appeal to review the State Court's judgment.

II. The exemption from tax for religious periodicals does not constitute a law "respecting an establishment of religion."

Section 151.312, Texas Tax Code, meets the three part test, established in *Lemon v. Kurtzman*, 403 U.S. 602, 612-613 (1971) to determine whether a statute violates the Establishment Clause:

> First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion, . . . finally, the statute must not foster "an excessive government entanglement with religion."

The secular legislative purpose of a tax exemption was described in *Walz v. Tax Commission*, 397 U.S. 664, 673 (1970) as "neither the advancement nor the inhibition of religion; it is neither sponsorship nor hostility." The state court found the purpose of Section 151.312 was to "restrict the fiscal relationship between church and state, and tends to compliment and rein-

force the desired separation insulating each from the other." 731 S.W.2d 160, 163 (Tex. App.-- Austin 1987, writ ref'd n.r.e.).

Appellees do not remember asserting at the state court level, as alleged by Appellant, that the secular legislative purpose of Section 151.312 was to prevent an excessive entanglement with religion. Appellees did raise that with regard to the equal protection attack the legitimate state purpose for the provision was to help avoid a violation of the Establishment Clause by preventing the State from becoming excessively entangled with religion.

The secular purpose ("neutrality test") requirement is aimed at preventing the government from abandoning neutrality and acting with the intent of promoting a particular point of view in religious matters. *Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints et al v. Christine Amos,* 107 S.Ct. 2862, 2868 (1987). The purpose of Section 151.312 is neutrality toward religion publications.

The exemption does not have the primary effect of advancing or inhibiting religion ("effects test"). It creates under *Walz* only a "minimal and remote involvement between church and State and far less than taxation of churches." 397 U.S. at 677. In *Walz* this Court held *"There is no genuine nexus between tax exemption and establishment of religion."* 397 U.S. at 677 (emphasis supplied).

The exemption does not single out religion to receive a benefit not available to other charitable causes. Under the Texas sales and use tax statute an organization created for educational or charitable purposes is exempt on its purchases provided no part

of the net earnings of the organization benefits a private shareholder or individual and the items purchased are related to the purpose of the organization. Texas Tax Code Section 151.310(a)(l), p. App. 1, *infra*. Section 151.312 exempts both the sale and purchase of religious periodicals. Section 151.310 exempts only a purchase of tangible personal property but covers the purchase of a publication printed for and related to the advancement of the organization. Section 151.310(c), Texas Tax Code, permits a one day tax free sale or auction once a year by an educational or religious organization. The sale encompasses any type of tangible personal property including magazines or other publications printed for and related to the advancement of the organization. Charitable and educational organizations are given similar benefits under the Texas sales and use tax act to those accorded to religious organizations.

The fact religion may receive a benefit not available to other charitable causes does not mean Section 151.312 is advancing religion. As noted in *Walz* supplying of costly teaching materials is not a legislative aid to religion. 397 U.S. at 673. *See Board of Education of Central School District No. 1 v. Allen*, 392 U.S. 236, 248 (1968). Why then should an exemption for sales of religious periodicals be classified as such? After a determination is made, if any, regarding the entitlement to the exemption, there is no further involvement between the State and the church. The government may accommodate religious practices without violating the Establishment Clause. *Hobbie v. Unemployment Appeals Commission of Florida et al*, 107 S.Ct. 1046, 1051 (1987). The testimony indicates the agency administering the tax, Appellee Comptroller of Public Accounts, interprets Section 151.312 in such a manner that the parties to the sale transaction make

the decision on whether the sale is exempt under Section 151.312.

A law is not unconstitutional simply because it allows churches to advance religion. "But religious groups have been better able to advance their purposes on account of many laws that have passed constitutional muster: for example, the property tax exemption at issue in *Walz v. Tax Comm'n, supra*, or the loan of school books to school children." *Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints et al v. Christine Amos.* 107 S.Ct. at 2868.

Section 151.312 does not create an excessive entanglement with religion. Appellant argues the exemption requires the State to determine (1) whether the publisher or distributor is a "religious faith" and (2) whether the contents of the publication consist "wholly of writings promulgating the teaching of the faith." Even if the State must make these decisions, the grant of the exemption leads to lesser involvement with religion by the State than does taxation. If a seller of publications qualifying for exemption under Section 151.312 became delinquent in the collection and payment of tax on such sales, Appellee Comptroller of Public Accounts would under his normal collection process file tax liens against the property of the seller under the authority of Texas Tax Code Section 113.002, p. App. 3, *infra*, issue notices to freeze money in bank accounts under Texas Tax Code Section 111.021, p. App. 4, *infra*, and if property were owned by the seller, could by extra judicial procedures seize and sell the property to satisfy the tax debt pursuant to Texas Tax Code Section 111.017, p. App. 6, *infra*, Government's involvement with religion would be greatly expanded, if the exemption were not present. The making of a mere decision whether a publication

qualifies for exemption does not create the great degree of involvement with religion that the elimination of the exemption would cause.

Due to its passive nature, Section 151.312 does not create an ongoing partnership between the State and religion presented by direct aid. Once the sale of the publication is determined to be exempt there is no further action needed by the state or religion. The exemption has been applied in such a manner that "official and continuing surveillance" by the government is avoided. The administration of Section 151.312 prevents practically any State involvement.

Although the agency construction of Section 151.312 does not appear in its rule (34 Tex. Admin. Code Section 3.299(d)), State law is that an agency's interpretation of its own rule is to be considered part of the rule. *Texarkana and Ft. S. Ry. Co. et al v. Houston Gas & Fuel Co.*, 121 Tex. 594, 51 S.W.2d 284, 287 (1932); *Lawyers Title Ins. Corporation v. Board of Ins. Com'rs et al*, 207 S.W.2d 972, 976 (Tex. Civ.App.-- Austin 1948, writ ref'd n.r.e.). The State court was properly entitled to rely on the agency construction regarding Section 151.312.

Appellant also asserts that Appellee Comptroller's construction of Section 151.312 is not binding under Texas law. Under Texas law when a statute is ambiguous, the agency construction of the statute should be followed. *Federal Crude Oil Co. v. Yount Lee Oil Co.*, 122 Tex. 21, 52 S.W.2d 56, 62 (Tex. 1932), *Lumbermen's Underwriters v. State Board of Insurance*, 502 S.W.2d 217, 220 (Tex. Civ. App.-- Austin 1973, writ ref'd n.r.e.); and *Davis Kemp Tool Co. Inc. v. Bullock*, 584 S.W.2d 579 (Tex. Civ. App.-- Beaumont, writ ref'd n.r.e.) per curiam, 590 S.W.2d 708 (Tex.

1979). The provisions of Section 151.312 are ambiguous. What is a book consisting wholly of writings sacred to a religion or religious faith? In recognition of this ambiguity, Appellee Comptroller has not attempted to decide what publications qualify under Section 151.312. Appellee's construction should be accepted under existing state law. It is a reasonable construction of the exemption and one that does not involve an excessive entanglement with religion.

Even disregarding Appellee's construction, Section 151.312 is constitutional. It has a valid secular purpose, it neither advances nor inhibits religion and does not foster an excessive entanglement with religion.

CONCLUSION

Appellees respectfully submit that the Questions upon which this appeal is based are so unsubstantial as not to need further argument and Appellees respectfully move the court to dismiss the appeal, or, in the alternative, to affirm the judgment entered in the cause by the Court of Appeals, Third Supreme Judicial District, Austin, Texas.

Respectfully submitted,

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APPENDIX A

Section 151.310

151.310. Religious, Educational, and Public Service Organizations

(a) A taxable item sold, leased, or rented to, or stored, used, or consumed by, any of the following organizations is exempted from the taxes imposed by this chapter:

(1) an organization created for religious, educational, or charitable purposes if no part of the net earnings of the organization benefits a private share holder or individual and the items purchased are related to the purpose of the organization;

(2) an organization qualifying for an exemption from federal income taxes under Section 501(c)(3), (4), (8), (10), or (19), Internal Revenue Code, of the item sold, leased, rented, stored, used, or consumed relates to the purpose of the exempted organization and the item is not used for the personal benefit of a private stockholder or individual;

(3) a nonprofit organization engaged exclusively in providing athletic competition among persons under 19 years old if no financial benefit goes to an individual or shareholder;

(4) a company, department, or association organized for the purpose of answering fire alarms and extinguishing fires or for the purpose of answering fire alarms, extinguishing

fires, and providing emergency medical services, the members of which receive no compensation or only nominal compensation for their services rendered, if the taxable item is used exclusively by the company, department, or association; or

(5) a chamber of commerce or a convention and tourist promotional agency representing at least one Texas city or county if the chamber of commerce or the agency is not organized for profit and no part of its net earnings inures to a private shareholder or other individual.

(b) The sale of, or contracting for the sale of, concessions at an event conducted by an organization exempted under Subsection (a)(3) of this section does not prevent the application of the exemption to that organization.

(c) An organization that qualifies for an exemption under Subsection (a)(l) of this section may hold one tax-free sale or auction during a calendar year and the tax-free sale or auction may continue for one day only. The sale of a taxable item by a qualified organization at a tax-free sale or auction is exempted from the sales tax imposed by Subchapter C of this chapter. The storage, use, or consumption of a taxable item acquired from a qualified organization at a tax-free sale or auction is exempted from the use tax imposed by Subchapter D of this chapter until the item is resold or subsequently transferred.

(d) If two or more organizations jointly hold a tax-free sale or auction, neither organization may hold another tax- free sale or auction during the calendar year. The employment of and payment of a reasonable fee to an auctioneer to conduct a tax-free

auction does not disqualify an otherwise qualified organization from receiving the exemption provided by Subsection (c) of this section.

APPENDIX B

Section 113.002

113.002. Tax Lien Notice

(a) The comptroller shall issue and file a tax lien notice required by this chapter.

(b) A tax lien notice must include the following information:

(1) the name and address of the taxpayer;

(2) the type of tax that is owing;

(3) each period for which the tax is claimed to be delinquent; and

(4) the amount of tax only due for each period, excluding the amount of any penalty, interest, or other charge.

(c) A tax lien notice may include other relevant information that the comptroller considers proper.

APPENDIX C

Section 111.021

111.021. Notice to Holders of and Levy Upon Assets Belonging to Delinquent

(a) If a person is delinquent in the payment of an amount required to be paid or has not paid an amount claimed in a determination made against the person, the comptroller may notify personally or by registered mail any other person who:

(1) possesses or controls a credit, bank or savings account, deposit, or other intangible or personal property belonging to the delinquent or the person against whom the unpaid determination is made, hereafter referred to as "assets"; or

(2) owes a debt to the delinquent or person against whom the unpaid determination is made.

(b) A notice under this section to a state officer, department, or agency must be given before the officer, department, or agency presents to the comptroller the claim of the delinquent or person to whom the unpaid determination applies.

(c) A notice under this section may be given at any time within three years after the payment becomes delinquent or within three years after the last recording of a lien filed under this title, but not thereafter. The notice must state the amount of taxes, penalties and interest due and owing, and an additional amount of interest that will accrue by operation of law in a period not to exceed 30 days and,

in the case of a credit, bank or savings account or deposit, is effective only up to that amount.

(d) On receipt of a notice given under this section, the person receiving the notice:

(1) within 20 days after receiving the notice shall advise the comptroller of each such asset belonging to the delinquent or person to whom an unpaid determination applies that is possessed or controlled by the person receiving the notice and of each debt owed by the person receiving the notice to the delinquent person or person to whom an unpaid determination applies; and

(2) may not transfer or dispose of the asset or debt possessed, controlled, or owed by the person at the time the person received the notice for a period of 60 days after receipt of the notice, unless the comptroller consents to an earlier disposal.

(e) A notice under this section that attempts to prohibit the transfer or disposal of an asset possessed or controlled by a bank is not effective unless it is delivered or mailed to the principal office of the bank or the office of the bank at which the deposit is carried or the credit or property is held.

(f) A person who has received a notice under this section and who violates Subdivision (2) of Subsection (d) of this section is liable to the state for the amount of indebtedness of the person with respect to whose obligation the notice was given to the extent of the value of the asset or debt transferred or disposed of.

(g) At any time during the last 45 days of the 60-day period as stated in Subdivision (2) of Subsection (d) of this section, the comptroller may levy upon the asset or debt. The levy shall be accomplished by delivery of a notice of levy, upon receipt of which the person possessing the asset or debt shall transfer the asset to the comptroller or pay to the comptroller the amount owed to the delinquent or to the person against whom the unpaid determination is made.

(h) A notice delivered under this section is effective at the time of delivery against all property, rights to property, credits, and/or debts involving the delinquent taxpayer which are not at the time of such notice subject to an attachment, garnishment, or execution issued through a judicial process.

(i) Any person acting in accordance with the terms of the notice of freeze or levy issued by the comptroller is discharged from any obligation or liability to the delinquent taxpayer with respect to such property or rights to property, credits, and/or debts of the taxpayer affected by compliance with the notice of freeze or levy.

APPENDIX D

Section 111.017.

111.017. Seizure and Sale of Property

Before the expiration of three years after a person becomes delinquent in the payment of any amount under this title, the comptroller may seize and sell at public auction real and personal property of the person. A seizure made to collect the tax is limited only to property of the person that is not exempt from execution.

(1)

Supreme Court, U.S.
FILED
JUN 2 1988
JOSEPH F. SPANIOL, JR.

No. 87-1245

In The

Supreme Court of the United States

October Term, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

JOINT APPENDIX VOLUME I

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The Jurisdictional Statement was filed January 22, 1988
Probable Jurisdiction Noted on March 21, 1988

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DATE	PLEADINGS FILED
5-14-85	Defendants' Original Answer—Bob Bullock, Comptroller of Public Accounts of the State of Texas; Jim Mattox, Attorney General of the State of Texas; Ann Richards, Treasurer of the State of Texas and the State of Texas
2- 3-86	Both parties announced ready. Witnesses placed under rule. Opening statements. Evidence commenced. Recess at 5:10 P.M. until 9 A.M. 2/4/86
2- 5-86	Arguments. Judgment for Plaintiff holding exemption unconstitutional. J. Dibrell
3-18-87	REVERSED AND RENDERED: Opinion by Chief Justice Shannon; dissenting opinion by Justice Carroll
5- 6-87	Appellee's motion for rehearing en banc submitted and overruled. (MO # CV-21,276)
5-27-87	Appellee's motion for rehearing submitted and overruled—substituted opinion by Chief Justice Shannon; dissenting opinion by Justice Carroll. (MO# CV-21,274)
6-24-87	Appellee's second motion for rehearing submitted and overruled. (MO# CV-21,422)
9-23-87	App writ err disp
10- 8-87	Rehearing Filed
10-15-87	Rehearing Forwarded
10-28-87	Rehearing Disp

DEFENDANTS' ORIGINAL ANSWER

Filed, May 14, 1985

NO. 378,384

TEXAS MONTHLY, INC.	)	
	)	
Plaintiff,	)	
	)	IN THE
VS.	)	DISTRICT
	)	COURT OF
STATE OF TEXAS, BOB	)	TRAVIS
BULLOCK, COMPTROLLER	)	COUNTY,
OF PUBLIC (sic)	)	TEXAS
OF THE STATE OF TEXAS,	)	
JIM MATTOX, ATTORNEY	)	345TH
GENERAL OF THE STATE OF	)	JUDICIAL
TEXAS, AND ANN RICHARDS,	)	DISTRICT
TREASURER OF THE STATE	)	
OF TEXAS,	)	
	)	
Defendants.	)	

DEFENDANTS' ORIGINAL ANSWER

TO THE HONORABLE JUDGE OF SAID COURT:

COME NOW Bob Bullock, Comptroller of Public Accounts of the State of Texas; Jim Mattox, Attorney General of the State of Texas; Ann Richards, Treasurer of the State of Texas, and the State of Texas, Defendants, herein, and would show the Court as follows:

I.

Defendants deny each and every allegation contained in Plaintiff's Original Petition filed herein, and demand strict proof thereof.

WHEREFORE, PREMISES CONSIDERED, Defendants pray that Plaintiff take nothing by its suit and that all costs incurred herein be taxed against Plaintiff, and for such other and further relief both in law and in equity, to which Defendants may be entitled.

Respectfully submitted,

JIM MATTOX
The Attorney General of Texas

DAVID R. RICHARDS
Executive Assistant

HARRIET D. BURKE
Assistant Attorney General
Chief, Taxation Division

/s/ David Mendez
DAVID MENDEZ
Assistant Attorney General
Bar Card No. 13932575
P. O. Box 12548
Austin, Texas 78711-2548
(512) 475-1013

ATTORNEYS FOR
DEFENDANTS

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Defendants' Original Answer has been sent certified mail, return receipt requested, to Attorney for Plaintiff, R. James George, Jr., GRAVES, DOUGHERTY, HEARON & MOODY, this 13th day of May, 1985.

/s/ David Mendez
DAVID MENDEZ

PLAINTIFF'S SECOND AMENDED
ORIGINAL PETITION

Filed, January 15, 1986

NO. 378,384

TEXAS MONTHLY, INC.,	)	
	)	
Plaintiff,	)	
	)	IN THE
VS.	)	DISTRICT
	)	COURT OF
STATE OF TEXAS, BOB	)	
BULLOCK, COMPTROLLER	)	TRAVIS
OF PUBLIC ACCOUNTS OF	)	COUNTY,
THE STATE OF TEXAS, JIM	)	TEXAS
MATTOX, ATTORNEY	)	
GENERAL OF THE STATE	)	345TH
OF TEXAS, and ANN	)	JUDICIAL
RICHARDS, TREASURER OF	)	DISTRICT
THE STATE OF TEXAS,	)	
	)	
Defendants.	)	

PLAINTIFF'S SECOND AMENDED
ORIGINAL PETITION

TO THE HONORABLE JUDGE OF SAID COURT:

Now comes TEXAS MONTHLY, INC., a Texas corporation, hereinafter referred to as Plaintiff, complaining of the STATE OF TEXAS, BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS, and ANN RICHARDS,

TREASURER OF THE STATE OF TEXAS. In support of its claim, it will show the Court the following:

I.

This is a suit brought pursuant to § 112.001, *et seq.*, Texas Tax Code.

II.

On January 21, 1985 Plaintiff paid $21,137.53 in protest. On February 20, 1985 Plaintiff paid $8,982.37 in protest. On March 25, 1985 Plaintiff paid $10,073.68 in protest. On April 19, 1985 Plaintiff paid $14,118.68 in protest. On May 20, 1985 Plaintiff paid $13,606.63 in protest. On June 19, 1985 Plaintiff paid $7,994.56 in protest. On July 19, 1985 Plaintiff paid $10,582.93 in protest. On August 20, 1985 Plaintiff paid $12,763.83 in protest. On September 19, 1985 Plaintiff paid $10,406.97 in protest. On October 18, 1985 Plaintiff paid $16,086.52 in protest. On November 18, 1985 Plaintiff paid $14,333.91 in protest. On December 18, 1985 Plaintiff paid $9,020.13 in protest. A copy of each of the letters of protest are attached hereto.

III.

The taxes at issue here are sales taxes collected on the sale of magazines. The tax is imposed by § 151.051, Texas Tax Code. Magazines had been exempt from the sales tax prior to the repeal of § 151.320, by Acts 1984, 68th Leg. 2nd Called Session, p. 552, Ch. 31, art. 12, § 4 effective October 2, 1984.

IV.

Plaintiff publishes a magazine known as *Texas Monthly* in Austin, Texas and it sells the magazine by subscription sales and single copy sales to Texas residents. There are many other magazines that sell to Texas residents. Many of those magazines do not have any offices in Texas. The Comptroller has entered into an intentional plan to collect the sales tax from only those magazines that have offices in Texas, especially magazines such as Plaintiff. The Comptroller makes no effort to collect the sales tax from companies that sell magazines in Texas, but which have no offices in Texas. Such conduct constitutes an unlawful plan and scheme of taxation that violates Article 8, § 1 of the Constitution of Texas.

V.

The unlawful plan and scheme of taxation described in paragraph IV above also violates Article 1, § 3 of the Constitution of Texas and the Fourteenth Amendment to the Constitution of the United States.

VI.

Section 151.312 exempts from the sales tax religious periodicals. Such an exemption constitutes an unlawful discrimination based on the content of a publication and thus violates Plaintiff's rights guaranteed by the First and Fourteenth Amendments to the Constitution of the United States and Article 1, § 8 of the Constitution of Texas.

VII.

The collection of a sales tax on the very act of speaking and publishing constitutes a tax upon the privileges

guaranteed by the First and Fourteenth Amendments of the Constitution of the United States and Article 1, § 8 of the Constitution of Texas. In particular, the tax collection practices discriminate against in-state magazine publishers as compared to all other types of printed material in that they must compete with magazines that pay no taxes.

VIII.

The imposition of the sales and use tax to magazine subscription sales discriminates in its operation against the magazine industry since there is no effective way to collect the tax from readers. It is a gross receipts tax in its operation as it affects magazines sold through mail subscriptions while it can be passed on and does operate as a sales and use tax for other industries. Therefore, it violates the First and Fourteenth Amendments to the Constitution of the United States.

WHEREFORE, PREMISES CONSIDERED, Plaintiff prays that it recover a judgment against each Defendant, jointly and severally, as provided by statute, for $149,107.74, plus statutory interest, costs, and such other relief at law or in equity to which it shows itself entitled.

Respectfully submitted,

GRAVES, DOUGHERTY,
HEARON & MOODY
2300 InterFirst Tower
P. O. Box 98
Austin, Texas 78767
512/480-5600

By: /s/ R. James George, Jr.
R. James George, Jr.
State Bar ID #07810000
ATTORNEYS FOR PLAINTIFF

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Plaintiff's Second Amended Original Petition has been mailed, certified mail, return receipt requested, to counsel of record for all Defendants, to-wit: Mr. David Mendez, Assistant Attorney General, Office of the Attorney General of the State of Texas, P. O. Box 12548, Austin, Texas 78711 on this the 14 day of January, 1986.

/s/ R. James George, Jr.
R. James George, Jr.

(p. 1) NO. 378,384

TEXAS MONTHLY, INC.	)	
	)	
VS.	)	
	)	IN THE 345TH
STATE OF TEXAS, BOB	)	JUDICIAL
BULLOCK, COMPTROLLER	)	DISTRICT
OF PUBLIC ACCOUNTS OF	)	
THE STATE OF TEXAS,	)	TRAVIS
JIM MATTOX, ATTORNEY	)	COUNTY,
GENERAL OF THE STATE	)	TEXAS
OF TEXAS, AND ANN	)	
RICHARDS, TREASURER OF	)	
THE STATE OF TEXAS	)	

STATEMENT OF FACTS

VOLUME ONE

BEFORE THE HONORABLE JOE B. DIBRELL, JR.

APPEARANCES

MR. R. JAMES GEORGE, JR. AND
MR. ERIC G. BEHRENS,
Graves, Dougherty, Hearon & Moody
2300 First RepublicBank Tower,
Austin, Texas 78767 78701
ATTORNEYS FOR THE PLAINTIFF

MR. DAVID MENDEZ AND MS. HARRIET D. BURKE,
Attorney General's Office
210 Barton Springs Road,
Fourth Floor,
Austin, Texas 78704
ATTORNEYS FOR THE DEFENDANTS

(p. 2) BE IT REMEMBERED, that on the 3rd, 4th and 5th days of February, A.D. 1986, the above numbered

and entitled cause came on for hearing before the HONORABLE JOE B. DIBRELL, JR.

WHEREUPON the following evidence was given and proceedings were had, to-wit:

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HAROLD LEE
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STEPHEN A. CHILDS
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Plaintiff's Exhibit No. 1	9	9
Plaintiff's Exhibit No. 2	9	9
Plaintiff's Exhibit No. 3	9	9
Plaintiff's Exhibit No. 4	9	9
Plaintiff's Exhibit No. 5	9	9
Plaintiff's Exhibit No. 6	9	9
Plaintiff's Exhibit No. 7	9	9
Plaintiff's Exhibit No. 8	9	9
Plaintiff's Exhibit No. 9	9	9
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Plaintiff's Exhibit No. 24	54	
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DESCRIPTION	MARKED	RECEIVED
Plaintiff's Exhibit No. 37	205	207
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(p. 6) THE COURT: The Court recognizes and the State has presented its plea to the jurisdiction filed on January the 3rd for the Court's consideration, wherein it is pleading that the Court is without jurisdiction to take up paragraph eight of plaintiff's second amended original petition. The Court will take such plea under advisement, will not rule on it until a later time before I can proceed further and become familiar with the actual issues in the case. I think to take it up at this time would probably disrupt an orderly process for proceeding with the evidence in the case, and so I'm just going to take it under advisement.

MR. GEORGE: Thank you Your Honor. Let me begin with a preliminary and in the process address this issue as we go. We have a sales and use tax issue. Tax on magazine subscription sales is the issue. The tax in question was passed during the special legislative session in the summer of 1984 and became effective on October 2nd, 1984, and the taxpayer's first obligation to remit

taxes was for the quarter—the last quarter of 1984, and that tax was remitted pursuant to a protest (p. 7) letter filed that is—a copy of which is attached to the petition and—February 21st—I'm sorry—January 21st, 1985. That was drafted by Mr. Gerhart, and a copy is attached to all of our pleadings in this case and was for the sum paid at that time of $21,000, as I recall. A copy of that is attached to Mr. Mendez' plea to the jurisdiction, and I would mark that and introduce it. I believe we have a stipulation these all can be introduced.

MR. MENDEZ: No objection.

MR. GEORGE: Would you mark that Exhibit 1, please?

MR. MENDEZ: If I may, Your Honor, are we going into the evidence right now, or do we have time for an opening statement in this case, or what are we doing?

MR. GEORGE: Well, Mr.—what I would plan to do, Your Honor, is to cover the preliminaries of the protest being made and entered and then introduce the issues by referencing to the protest letters that it raised as—one, because it gives a context to plea to the jurisdiction, and two, it gives the Court the chronology of the events involved and (p. 8) the issues raised in the protest and then make my opening statement after these are put in simply because it's the easiest way.

THE COURT: That's all right. That's all right. Then you can have an opportunity to make an opening—

or a response opening statement before I proceed with the evidence.

MR. GEORGE: Before I call any witnesses certainly would be the case.

(At this time there was a brief discussion off the record.)

MR. GEORGE: Why don't we invoke the rule at this point in time?

MR. MENDEZ: Okay. Can I designate Wanda Hutcheson then as our agency representative?

THE COURT: All right. Any other witnesses?

MR. GEORGE: Is there any witnesses in the courtroom?

MR. MENDEZ: Yes, there are.

THE COURT: All of you please stand and be sworn.

(p. 9) (At this time all witnesses present were sworn.)

THE COURT: All right. The rule has been invoked; therefore, it's going to be necessary for all of the witnesses, other than the parties and designated representative, will be out of the courtroom at all times while testimony or other proceedings are being presented to the Court. You are further instructed not to discuss your testimony with any of the other witnesses in the cause but only with counsel.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 1 through 23 for identification, and a brief recess was taken, after which time the proceedings continued as follows:)

MR. GEORGE: Okay. We will offer into evidence Exhibits 1 through 23.

THE COURT: Any objection? If there's no objection, they will be admitted.

MR. GEORGE: These represent the letters of protest that have been filed by the taxpayer each month, with the exception of the first payment, which was on a (p. 10) quarterly basis. The taxpayer has paid the tax under protest, and the basis of protest is set out in there. With relevance to Mr. Mendez' plea to the jurisdiction, there are three different kinds of letters. There are the letter that was written by Mr. Gerhart, general manager, on the first one, which is a pretty general letter, a letter that I authored, which are exhibits—which is the February letter through October of '85, which are essentially the same. Then there is the September payment which was sent on October 18th, which was different in that it added the language that appears in paragraph eight to the second amended petition, which was filed within 90 days of the mailing of this letter on whenever it was—January something, and that petition tracked this letter. It is our position in response to the plea to jurisdiction so that the record will be a response. If we recover on the basis of the language in paragraph eight, we would be entitled to recover only for those letters that are with each month that contain the right language and not for the protest of others. We can—I think the statute contemplates each (p. 11) month's payment as a separate controversy, and we've filed them on that basis. I introduce those, and let me now turn to my opening statement.

As I say, this is a sales and use tax case, with the sales tax on magazine subscriptions being effective on October 2nd, 1984 and part of the legislation passed that summer session. We have come to the Court—well, first of all this is a sales tax that applies to magazine subscription sales on its face that is—there is no particular language addressing magazine subscriptions. They are simply nonexempt. It applies facially neutral to magazine subscription sales just like all other tangible property. So there is nothing in the statute that singles out magazines for particular treatment by language of the statute. We contend that nevertheless we are entitled to relief from the burden of paying the tax for constitutional reasons, and there are three basic reasons for that.

The first surrounds a case—the first two—a Minnesota—the Minnesota case, I'll call it. It's the *Minneapolis Star* (p. 12) *Tribune v. Minnesota Tax Commissioner*, a copy of which is in the notebook. That is a sales and use tax case by the Supreme Court of the United States in 1983. That case established—involved a use tax on the ink and paper used to print newspapers in Minnesota. There was a general use and sales tax in Minnesota that was essentially the same as Texas. The basic proposition of sales tax is the person who uses the underlying product pays the tax. When I go to Merritt, Schaefer & Brown and buy myself a new pair of socks, they give me the socks. I gave them the money plus the tax. I pay the tax. When I use something from out of state, I'm obligated to pay the tax. If I don't pay the tax to the vendor, I'm supposed to pay a use tax. It's the basic system in Minnesota that is in existence in Texas operating the same

way. The newspaper subscriptions and newspaper sales were exempt. Most other—

THE COURT: Is this—excuse me for a question and its lack of order—something out of a catalog?

MR. GEORGE: Yes, sir, that's a critical part of this case—is mail (p. 13) orders, exactly.

THE COURT: All right, and if I order something out of a catalog and it's shipped from Oklahoma and—but it's shipped to me as an ultimate consumer, I'm supposed to pay a Texas sales tax?

MR. GEORGE: That's right. The statute is—you're supposed to pay a use tax.

THE COURT: A use tax? But they call it a sales tax, of course?

MR. GEORGE: Well, the statute is a sales and use tax and it operates—and these statutes began during—right after the depression, and they're operated to avoid consumers buying everything by out of state vendor so the state will not lose all of its revenue. Therefore, there is an intergrated tax system in Texas, as there was in Minnesota, to levy a tax—it varies in Texas from place to place—on the use of—purchase and use of tangible personal property. Now, the Minnesota tax like Texas—generally exempt component parts. If you are manufacturing a radiator and you put all of the parts in, you don't pay use (p. 14) taxes generally on what you put together. The concept is the tax is paid when the man buys the radiator from you. Then the use tax—or the sales tax is paid, or if doesn't—if he's exempt for some reason, he pays a use

tax to the State. That is the concept. In Minnesota they singled out newspapers to tax the ink and paper, even though the ultimate subscriptions were exempt, and the Supreme Court said, "You can't do that." The reason—you treated them differently. Now, also that tax in operation—while facially neutral in the sense it applied to all newspapers, when you computed up the money, there were only two newspapers. One, the big one in Minneapolis, paid two thirds of all of the taxes collected under that provision. They said that discriminates against a particular member of the press; and therefore, it's unconstitutional for those two reasons. The important part of that case—and the case is critically important because it tracks the constitutional history of the First Amendment and the levying of tax on the press citing some of the Federalist papers and others, in which they said, "Taxes on the press have particular (p. 15) scrutiny," and they said—and this is a critical part of it—is the compelling interest test applies. The recognition was that for all other tax disputes the Legislature has very wide discretion. It can decide to tax combines and not tractors. It can decide to do—and if is has a rational reason, then it's not subject to dispute. They have varied widely to raise revenue. The important holding is that the First Amendment—

THE COURT: This is to quote the First Amendment? Then I understand.

MR. GEORGE: —First Amendment, because of the constitutional—the sensitivity of taxes on the press to any tax that operates—that is facially discriminatory or operates in a discriminatory manner—that discriminates against the press is one that must be justified by com-

pelling interest. There must be a compelling reason that you do it this way.

THE COURT: And not just to raise revenue?

MR. GEORGE: And not just to raise revenue, and so that's the critical part, and we believe the facts. We have—will (p. 16)—prove two kinds of discrimination. The first kind of discrimination is what we call a discrimination against Texas magazines. We believe that the evidence will show that the tax is paid by Texas magazines, but all of the other magazines that you read, such as *Reader's Digest* and *American Sportsman* and all of those other magazines—no tax is paid or collected; and therefore, only people who happen to have their home offices in Texas pay the tax, and we will show there's plenty of constitutional power to tax the other people, if they chose to. Second—and this is paragraph eight issue that we need to—that Mr. Mendoz has objected to—is what we call the gross receipts effect. We will show that for magazines sold by mail order by subscriptions there is no effective way to collect the tax; that is, if you go into Merritt, Schaefer & Brown and buy a pair socks, they can say, "Pay the tax or don't get the socks. If you order—because of the peculiarities of dealing through the mail and the economics of the magazine industry, if you order magazines and you don't deliver them because of failure to pay the tax, you go out of (p. 17) business. It operates and is paid by the Texas magazine industry and by my client as a gross receipts tax because they have found it impossible to collect on—

THE COURT: Can't they have it included in their subscription price?

MR. GEORGE: Well, you can raise your price is the theory—raise your price, and if you raise your price, you decrease your subscribers, but more importantly you are, one, paying essentially gross receipts tax. If you simply raised your price and paid 6.12 percent of everything you take the State of Texas, that's very different than I can have—Merritt, Schaefer & Brown can have a sale and still charge me the tax and make me pay it, and it doesn't matter to them whether the tax is there or not. Texas Monthly can't do that because they've got to take it off the top and send it in because they can't get you to pay it to them, and the evidence will show that. That's called the gross receipts effect and that—this is discrimination—

THE COURT: Really the question is the mechanics, and you'll get into (p. 18) that, won't you?

MR. GEORGE: I'll show that. The next constitutional concept is one which will also require substantial evidence, and that is one under Article 8, Section 1 of the Constitution of Texas. Now, this is a provision that's been in the Texas Constitution since the first constitution since we were a state in 1845, and it says, "All taxes shall be fair and equal," and it's been elaborated on to some extent, and it has been applied at least back to 1895 in cases in which a taxpayer can come in and show a plan or scheme to leave property off the tax roll and I—all of the cases under that statute that I have found are ad valorem cases, and I want to give that to the Court up front, but the statute—the constitutional division applies to all tax collectors. We will show that the Comptroller has a plan, scheme, intentionally does not collect tax from either the vendors of out of state magazines, the people who sell them, *Reader's*

Digest, although they have authority to do it and know it, made a political decision that it would be unwise to, and, two, they have (p. 19) made a political decision that although the statute requires consumers to pay the tax to not do anything to collect it from the consumers, and so if a citizen chooses to read *Texas Monthly*, they pay a tax, or tax is part of the gross receipts that they turn in. It is paid for them, but if they choose to read *Reader's Digest*, that doesn't happen, and the Comptroller knows that, knows that the Legislature, in its wisdom, made the *Reader's Digest* user just as liable for the tax as the *Texas Monthly* user, but they decided it's not a wise tax. It's not easy to collect so they're going—and it's politically devastating to an elected officer to go out and try to collect the tax from people who owe it. So they don't try.

THE COURT: It's paid then on the—

MR. GEOGE: Well, I don't know that they have any evidence that anybody ever paid it, but the cases that you will find under this statute are cases in which the Duval County School District decided that they could raise enough revenue from the oil companies, and so they went around got all of the oil companies (p. 20) to pay the ad valorem taxes and just winked at the farmers and ranchers in the county and they just didn't pay their taxes, and they never did anything about it, and they had a system to —in the old days when we taxed land and intangibles, they simply made no effort to tax these stocks and bonds and main deposits and all of those things. They just winked at that obligation because it's hard to collect, and they collected all of the money from the real estate developers. There's dozens of cases in Texas in which if a plaintiff

can prove that they do that and they're harmed—and my client will show—

THE COURT: Or they systematically do it, I assume?

MR. GEORGE: Yes, systematically do it. They do it—they consciously do it. They do it because they have—they just decide it's wise to do that, for whatever reason, beyond their power. In other words, the Legislature or somebody set up a system to tax that way, and they just don't think that's particularly a good idea. So they won't do it. That's unlawful. You have to show (p. 21) harm, and we intend to do that, and finally what I call the pure First Amendment issue in a part of our case, and that's the religious periodical exemption.

THE COURT: How do you determine what is religious and what isn't?

MR. GEORGE: Well, Ms. Hutcheson or Mr. Rogers either has a system of anything that is published by what they consider religious faith is exempt, or they read it and decide, all right?

THE COURT: What if *Texas Monthly* has an article in there by some Episcopal priest or someone else?

MR. GEORGE: We have had over the years a traditional religion review column. We had a guy named Bill Martin for years and years and years that wrote a column about—reviewed preachers. He would go to famous preachers around the state and write articles. He hasn't done that in a year or so, but that's a traditional thing. Our argument is that—and we'll show that there is a constitutional basis for exempting activities of churches along

with all other eleemosynary (p. 22) institutions; that is, you can exempt the Boy Scouts and the Baptist Church and the American Cancer Society and all of those other institutions, and the Constitution lists it that way, as does the statute for all other sales tax lists them that way, but there is a provision that if it's a religious periodical it doesn't pay any tax. Our argument is classic First Amendment, that is, the granting, withholding of government benefit based purely on what people say—not what they do. Now, that's a very important distinction because what churches do along with other eleemosynary institutions can be encouraged by the State, and I don't want the Court to think I'm arguing that this is unlawful to have things benefit churches. This one doesn't say anything about what they do. It says that if a—if there is a periodical published by a religious faith that consists of the teachings of that faith, it's exempt—nothing about activity, nothing about good works only about what is said in the periodical. We will present—

THE COURT: Isn't that a very fine line between activity and—

(p. 23) MR. GEORGE: Well, Your Honor, the classic case is the man carrying on the picket line. When he's walking around with the words on his sign, he's speaking. When he starts swinging the picket sign, he's acting, and that's a distinction that First Amendment cases require all of the time—is you can stop activity. You can—the government can reward or punish conduct. When conduct is speech, however, you can't do it, and that's in First Amendment cases, one of the classic distinctions that have to be drawn—is between the man who's making the speech

and the person who's doing things, and that's not an uncommon thing. The classic—we think the classic content based discrimination case is one in there which is—content discrimination is a case that is a picket case, which is a—we have a city—the Chicago Police Department versus a man named Mosely, and Mr. Mosely had a dispute with the school because they thought that they favored black students over white students, and he walked around outside with a picket sign that said Taylor High School discriminates in favor of blacks—peacefully, no disruption. He just (p. 24) walked around outside of the school. The City of Chicago passed an ordinance saying you can't picket schools, except if it's a bona fide language dispute. The Supreme Court said, "Mr. Mosely is entitled to picket." If you're going to give somebody an exemption from your ordinance based on what the sign says, you violate the First Amendment. They made it clear that if they're doing something bad—if they're beating up people or they're too close to school—I mean, you have a 25-yard set back rule or something else—all that is fine but only the ordinance—

THE COURT: But not content of the—

MR. GEORGE: —What the sign says. Here it's what the magazine says.

The COURT: I guess—do they ever get into the question about pornography on a sign? I know that puts it in a little bit different light.

MR. GEORGE: You know, in a case in which there is—I haven't dealt with—because there is the concept of unlawful speech, and there are three kinds of classic unlawful (p. 25) speech not involved in this case, but there

is pornography, which is obscenity, which is the legal term, which is unlawful speech. There is inciting to riot, which is the fire and—and that's unlawful speech and can be controlled, and then there is the treasonal State secrets—publishing secret military basis. Those are the classic kinds. The content of speech is subject to it. Nobody contends that even religious teachings or what *Texas Monthly*—is illegal. So we just have a classic content. There is one other case in that notebook you need to look at when you have the opportunity, which is *Speiser v. Randall*, which is a tax exemption First Amendment case, and during the 1950s California had a veterans' tax benefit where veterans had exemptions from certain ad valorem taxes, but they had a rule that if a veteran advocated the support of a foreign government they couldn't get the tax exemption. Justice Brennan or I think the Court said, "You can't have a tax exemption that turns on what people say," and we believe this exemption is that. Now, that's the outline of our case, and that's my opening statement.

(p. 26) THE COURT: Mr. Mendez?

MR. MENDEZ: Thank you, Your Honor. Well, if I may approach this—

THE COURT: Sure.

MR. MENDEZ: —I think it will help to visualize what our case is.

THE COURT: Do you want to flip the page or—

MR. MENDEZ: No. I think we can work with this. The first thing—let's go through this, and then I'll get to some of the other points that I want to raise, but Mr. George says that the Minneapolis Tribune case requires that the State show a compelling State interest for taxing

magazines. We haven't taxed anybody because what happened up here—we had a sales and use tax in place on all tangible personal property. We've, of course, taxed magazines—applied use taxes and sales taxes to them for years, as they're sold over the counter, and in fact, from the time that they were first created in 1963 even subscription sales—1961—even subscription sales were covered by the sales and use tax. About 1977 the Legislature, for whatever reason—I mean (p. 27) there's no clear indication of their intent—exempted subscription sales that were longer than six months in that from the tax.

THE COURT: That there were what?

MR. MENDEZ: If you sold a subscription to someone for a magazine, a periodical, and it was for a period longer than six months, it was exempt from sales or use tax. That was a provision. Well, we ran into a money crunch obviously in 1984. They were trying to fund the school systems and the new school fund, and they had to find money, and the legislators went in and started knocking out exemptions, which is a very good way of doing it, and they knocked out the exemption for religious—I mean, for subscription sales of magazines. So now they're back under the law—no tax on magazines. There have always been tax. There's no tax created on magazines. Minneapolis Tribune case—let's exempt everybody below a certain number of sales from the use tax, and let's stick it to these guys up here—these newspapers that are real big that happen to haxe been giving the Minnesota Legislature a hard (p. 28) time, by the way, and so that's the basis of that—of that Minneapolis Tribune case. We've got a case subsequent to that—a North Carolina case. The Village Publishing Company was assessed some sales and use

taxes. Well, let me give that one to the judge. I've got another copy. In North Carolina they assessed a tax on a newspaper over there, and they raised Minneapolis Tribune. You can't tax us because you're creating a special tax on us. What had happened is they had become subject to the general sales and use tax act. The Court said Minneapolis Tribune doesn't apply. They went to the Supreme Court. It was dismissed over there. Interesting argument, though, and probably we should deal with it, but we should deal with it on the basis that the Constitution works. You cannot discriminate between Texas magazines and out of state magazines, if they're in the same class similarly situated. That's a basic test. I mean, if you're going to complain—

THE COURT: What do you mean by situated?

MR. MENDEZ: Same person, same types of situations, the same type of (p. 29) person.

THE COURT: Not location?

MR. MENDEZ: Not location. It's not a geographical test. Another person—and that's a legitimate complaint. Another person just like me is being treated differently. I think that in order for them to prove that they've been harmed in this state they're going to introduce evidence that other magazines that are located in the State of Texas, have their headquarters here, and they sell to people maybe in Dallas or Houston—they're going to show that those people have also experienced the same types of problems. Exerybody is being affected by the tax the same way. They're going to try to show that there are some people outside the State of Texas that have such little contacts—those catalog sellers that you might

be purchasing from have such little contacts with the State of Texas that we are not doing anything to them. Well, there's a good reason. There's a Supreme Court case that says we can't do it—Bellas Hess.

THE COURT: What about Bullock's press statement here recently where (p. 30) the State is losing a lot of sales tax on our—

MR. MENDEZ: Exactly, but the reason we can't get them is because we can't force those people to collect a tax for us, and certainly it's obvious—and the cases have dealt with it, and we've cited them. If you'll kind of—kind of—we'll be citing cases about obvious and things that are general knowledge, but it is impossible for anybody to carry on a sensible system of taxation where every household in the state, in fact, every individual in the state has to hold a tax use permit just so that they can report the 3 or 4 or $5 or whatever that we may owe in taxes, as a result of out of state purchases that we use and consume and store in the state. That's a distinction.

Supreme Court case says we can't make those people collect it for us. Common sense and our carrying out our Legislative intent of revenue raising says that we're not going to spend 17 or 18 or $20 to go collect 5. That's this right here. Now, the Canteen case—*Canteen v. Calvert* in 1963 is a case where a vending machine person brought in (p. 31) the same problem that Mr.—that *Texas Monthly* is bring in here. They said, "We collect"—"We have these machines out there. People deposit money in them. How are we supposed to collect a use tax from those people? How are we supposed to collect a sales tax from selling products here in the State of Texas?" The Court said, "That's not an argument for not collecting tax. It's a

transaction. You've got your transaction. That's what gave rise to it, and if you can't show who"—"if you can't show or go out and collect it from someone else, you're still liable for the tax under constitutional law both in Texas"—and I think it also applied to federal constitutional law.

We go over here to Article 8, Section 1 of the Texas Constitution. This is a real heavy burden right here, harm, and I'll get into that in a minute, but I think that we have to talk first about uniformity and equality, as applied to these general classes. We cited the Hurt case—*Hurt v. Cooper* because that's the big case in that area, and I didn't give you a copy of it, Your Honor, but it permeates our brief but—and that was a general type tax, (p. 32) and it said—and it equates standards under the Texas equality statutes to, in fact, Article 8, Section 2 to the federal constitutional law and equal protection and due process, and so we cited it, but then lately we were looking at it. Well, why are there only property tax cases cited in Article 8, Section 1, and why are all of those cases always dealing with the statutory system by which assessments occur on the tax rolls of the particular county? Well, the reason is because there's some real old cases—two old cases—one from Edinburg and one—let me borrow this. We have the case of *Ana-Log, Inc. v. The City of Tyler* and *Edinburg Improvement Association v. The City of Edinburg*, and these cases say that you can't if the city official—if the county official that's assessing the tax applies the tax in an unequal manner, then Article 8, Section 1 does not apply. So on an as applied basis—and that's the only way you can get to a case in this court today—is that Mr. Bulloek or the Comptroller's office is

not applying the tax on an even basis by administration. Then it does—this statute doesn't apply. So it would have to be a plan (p. 33) set out in the statutes. The Legislalature picked on *Texas Monthly* and those people and didn't pick on others that were similarly situated? That's not the case we have here today because again similarly situated means those magazines that have nexus with the State of Texas, that have contacts sufficient to make the Comptroller—to allow the Comptroller to make them collect the tax for us. There's a bunch of people—and you'll here (sic) a lot of evidence on the millions and millions of dollars that are coming into this state in terms of—or that we're losing out on and that you've seen in the papers and maybe on TV, but there's no way for us to collect it.

Now, there's a—getting into a little but about the Supreme Court law on that, we have to call it a use tax because the United States Supreme Court said we had to. Sales tax cannot be assessed by the State for a transaction that's consummated in another state. So the vehicle is, okay, we can't tax that, but if you bring it in here and we use it, you've got sufficient nexus, and we'll pick it up from you, the consumer, or whoever—if the person (p. 34) that is selling it to you has sufficient contacts, we'll make him do it, and that's the reason for that constitutional gimmick of having these two complimenting taxes. We've covered that in our brief and the statutory scheme to give you an idea of how that works.

Now, this argument on religious publications. To answer your question as to why *Texas Monthly* wouldn't qualify, first of all, because it's not a religious—

THE COURT: Well, that's not the problem with me. My basic problem is the argument—I don't think they're

going to try to get qualified as a religious publication. Their problem basically is that by singling out you're using an invalid test for an exemption.

MR. MENDEZ: The test as—

THE COURT: Because content doesn't make—and that's a subjective test for someone else making it who may and may not and that invading the First Amendment.

MR. MENDEZ: Two things on that, Your Honor. First of all the evidence will show that the Comptroller doesn't want to get into deciding what's religious and what's (p. 35) not, in terms of content of a publication. So what they do, right or wrong—that may be something for you to decide—is that if it's a religious organization, if it meets all of the criteria set out by the Legislature under the Sales and Use Tax Act, anything that it publishes that is a periodical is going to be—a periodical that is sold on a regular basis is going to be exempted under that statute. The second thing is why do we have to get into that? The only thing that *Texas Monthly* can stand to gain from this is a voiding out of that exemption. Your Honor cannot bootstrap *Texas Monthly* into the religious periodicals exemption. It cannot expand an exemption. That's the way the constitutional law—

THE COURT: I don't think they're asking me to the way I read the statement so far; is that right? You're not asking to be bootstrapped into—

MR. GEORGE: Our position is such as *Speiser v. Randall* and the Chicago case. If there is an unlawful exemption in the statute, then you're entitled to be treated

equally to those people, which means not taxed (p. 36) until the Legislature chooses to abolish that exemption. That's the rule, and just like those veterans and just as Brennan's case and Speiser's case, their remedy was to get the tax exemption. They went in there and said, "You're not letting me have a tax exemption because I have advocated this position, and you're enjoined"—asked for an injunction from the State of California and enjoined them from not letting them have their exemption because somebody else got the exemption, and that's unequal protection. As long as that's on the books they cure it by repealing the statute.

MR. MENDEZ: Your Honor, we have to repeal the statute.

THE COURT: I don't have to. That's up to the Legislature.

MR. MENDEZ: Well, Your Honor, if that's—it's an exemption. The exemption is these people get treated special.

THE COURT: All right, but I don't—

MR. MENDEZ: And everybody else gets treated over here. I'd have to brief those cases. I'm not—

(p. 37) THE COURT: I know but I'm—well, it's clear enough to me as to the issue. I'm not—I will grant you that—

MR. MENDEZ: Well, Your Honor, our argument is these are the people that are being treated special. Everybody else is being treated in a uniform manner including *Texas Monthly,* and if these people are being treated spe-

cial and the reason they're being treated special is because—

THE COURT: Because of content.

MR. MENDEZ: —on content, then those people—because it's an exemption, they should be treated like everybody else, because if you work it the other way, then everybody that publishes anything, tha' writes letters maybe—I don't know—would have to be allowed to be exempted, and so you're enlarging the capacity of the exemption. So what you'd have to do is knock that out and say "Until you can show me that there's a valid reason for that, then you've got to do that.

THE COURT: All right.

MR. MENDEZ: So that's why (p. 38) we feel that that's at odds because there's nothing to gain from doing something like that. We're going to show that the State has valid reasons for doing that—avoiding entanglement, various other reasons, most of them which have been addressed in many U.S. Supreme Court cases and—

THE COURT: Okay.

MR. MENDEZ: Now, before we begin the evidence on this case, I want to remind Your Honor that when you've got a constitutional law case like this there are a lot of presumptions that run with the State and we felt real comfortable about this case all the way through, but we wouldn't file a motion for summary judgment because we didn't want to lose out on any of these presumptions, which are, as far as we're concerned, relatively insurmountable, at least under the facts today, to overcome. There's a presumption of constitutional act by the Comp-

troller's office and we've briefed that point out for Your Honor in detail. The acts of a state official are always presumed to be constitutional unless there's clear plainly—

(p. 39) THE COURT: That's a presumption of everything, isn't it, Counsel—presumption of constitutionality of everything pretty much in first flush?

MR. MENDEZ: Well, what you—you must uphold it, if there's any reasonable reason for upholding it. Any doubts that must be resolved—if you've got a doubt in your mind, you've got to resolve it in the Comptroller's favor, as far as how he administers the tax.

Now, from an evidence standpoint, if we're going to follow these Article 8, Section 1 cases, not only does he have to show you that he's been treated differently from others in his own class, not only does he have to show you that the Comptroller has some malicious intent or some other type of intent that borders. I guess, on the fraudulent, to do that, he's got to show you how many dollars he's going to be out-of-pocket that—different from the others in his class, and now, what we're going to go through in our defense basically is show you what the Comptroller's office does point by point, and (p. 40) it's going to be a long—an arduous journey, but I think we can make it interesting, and we'll show that the Comptroller does the best he can in administering these statutes, and in fact, it does—it goes well beyond the necessary limits of this constitutional argument.

We're going to show that there's no intentional plan of discrimination, and there's no intentional plan by the mere operation of the statutes, and then we're going to

show you in detail on what you've been reading in the paper or maybe seeing on TV—is what has the Comptroller been doing in Washington and throughout the country with the MTC and others to get those people that are similarly situated to Texas Monthly that might have nexus but where the law is real gray, and we've got people out there that are doing that job, and we're going to show the Court how that's being done, and in the end we're going to show that Texas Monthly doesn't meet any of those constitutional tests that it's set out here and that it can't show any harm to itself and with that in mind, Your Honor, we rest.

THE COURT: Thank you.

(p. 41) MR. GEORGE: One legal point because the Court is going to have to read the briefs, and we'll probably have a briefing schedule, but on the nexus similarly situated issue, I want the Court to look at a case called *Scripto v. Carson*, which is in my brief, which when the Court gets a minute, it's a case on the question of who can the State compel to collect the tax is the question of who has enough contacts with the State to do it, and the Scripto case involves agents who go into the state to take orders, and the Supreme Court said, "If you send people in or you have people"—"whether they're your employees or others"—"go into the state and take orders to sell your product in that state"—that's what they use in this—is nexus. That's plenty of contact with the State to do it, and we'll show that all of the national publications that are in—which we believe similarly situated have that. So—

THE COURT: Have people coming in?

MR. GEORGE: Yes, sir, or have agents here who take their orders and take orders for them and send them off and have them (p. 42) filled and people who are here in Texas. With that, we'll call our first—

THE COURT: Is that one of these people that knock on doors and come around with all of these magazine subscriptions wanting you to sign up for?

MR. GEORGE: Yes, sir.

THE COURT: Okay.

MR. GEORGE: Those are our order takers.

THE COURT: I understand.

MR. GEORGE: And those are order takers for all of the national magazines, and I will call Wanda Hutcheson.

THE COURT: Weren't you sworn?

THE WITNESS: Yes, sir.

WANDA HUTCHESON

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Ms. Hutcheson, would you state your (p. 43) full name and address for the record, please ma'am?

A. Wanda Hutcheson. I live at Route 1, Box 123-K in Lockhart, Texas.

Q. How are you employed?

A. I'm a—I work for the State Comptroller.

Q. How long have you been with the State Comptroller?

A. It will be 20 years in April.

Q. Is it true that your job is to tell the people who call into the Comptroller and who are seeking information from the Comptroller the Comptroller's policies on tax issues?

A. Yes, sir, that's correct.

Q. What's your position called?

A. Currently I'm administrative assistant to the Deputy Comptroller.

Q. And who's the Deputy Comptroller you're the administrative assistant to?

A. Mr. George Garland.

Q. And how—you were—gave a deposition back in the summer of '85 in this case. What was your position then?

A. Supervisor for sales tax policy.

(p. 44) Q. And was your duties then at that point in time to know the sales tax policy of the State of Texas and to communicate that to the public?

A. One of the duties, yes, sir.

Q. Are those still your duties?

A. Yes, sir.

Q. And how long have you been in the position of being aware of the sales tax policy of the State in communicating those to the public?

A. 15 or 16 years to some extent—one extent to—my responsibilities have increased, but I have been in policy for about 15 or 16 years.

Q. Now can you tell the Court how the sales and use tax works?

A. Sales tax is a tax that is collected from customers on sales made in Texas from Texas sellers. The use tax is a tax on merchandise coming into Texas from out of state.

Q. Now, is it the system of taxation that the—all transactions and uses of tangible personal property subject to the tax are supposed to be taxed under the statute?

(p. 45) A. Unless some exemption applies, all sales in Texas of tangible personal property are presumed subject to either the sales or use tax, yes, sir.

Q. And so that a use of a product purchased in another state is subject to the tax?

A. Yes, sir.

Q. And that's what the Legislature said?

A. Yes, sir.

Q. Okay. Now does it operate so that if my wife goes off to Bloomingdales in New York and have them mail her some china and we use it in our house that I'm obligated—or I guess she's obligated, I hope, to pay the use tax on that?

A. That transaction or that use would be subject to use tax, yes, sir.

Q. And when I order a copy of Runner's magazine from New York City and they send it to me and I pay the subscription, am I obligated to pay a use tax on that subscription?

A. Yes, sir.

Q. Now, I believe you told the Court during your deposition that you subscribed to Reader's Digest?

(p. 46) A. Yes, sir, I did at that time.

Q. And have you dropped your subscription?

A. It has lapsed, yes, sir.

Q. I'm sorry to hear that. Did you pay your sales—your use tax on your subscription to Reader's Digest when you subscribed?

A. No, sir, I did not.

Q. Have you ever paid a use tax on products that—or magazines that you've gotten through the mail?

A. Only those with—where the subscribers were in Texas and collected it or added it to the bill. If they added it to the bill, I paid it, yes, sir.

Q. But if someone sent you a magazine from out of state and there was no tax, they weren't—it's your understanding that if they live outside of the state they're not supposed to collect the tax—no obligation to collect the tax? Is that the policy of the Comptroller?

A. If they had no representation in Texas, that's correct, sir.

Q. And that's your policy?

A. Yes, sir.

(p. 47) Q. Okay, but do you have a form that citizens can file their use taxes with?

A. There is a form that is available, yes, sir.

Q. Do you distribute it? Have you ever sent one to a regular consumer like my wife who bought something from Bloomingdales to pay a use tax with?

A. Only if they request it.

Q. But, in fact, the matter is there has never been an effort by the Comptroller to go out and force any consumer to pay a use tax, has there, in the 20 years you've been there?

A. That's correct.

Q. And there has never been an organized system designed to encourage or foster or promote voluntary compliance, has there?

A. Not to individuals, no, sir.

Q. And in fact, you have sent out all of your mailings about compliance with this system to pay your use tax to businesses—not to consumers, haven't you?

A. Yes, sir. Those are the ones that we have on file, and those are the people that we know about, yes, sir.

(p. 48) Q. The Legislature didn't make that decision. You know that citizens and consumers are obligated to pay use tax just as my law firm as a business is obligated to pay use tax aren't they?

A. Yes, sir, that's correct.

Q. And in the 20 years that you've been with the Comptroller's office the use tax has been on the books, hasn't it?

A. Yes, sir.

Q. And during those 20 years, you or your supervisors have made the decision not to do anything to enforce that obligation against consumers, haven't you?

A. We have not made any effort to collect it from individuals as a general policy, yes, sir, that's correct.

Q. Now, you sat on a committee, did you not, that deals with the implementation of the new changes—the changes in the tax law that became effective October 2nd, 1984, did you not?

A. Yes, sir.

Q. And in fact, one of the things that were done involved the implementation of a bunch of items or taxes on a bunch of items that had (p. 49) not been subject to tax before—dry cleaning, for example?

A. Yes, sir, that's correct.

Q. Massage parlors?

A. Yes, sir.

Q. Turkish baths?

A. Yes, sir.

Q. A whole bunch of things that had never been subject to tax before; isn't that right?

A. That's correct.

Q. And in fact, the Comptroller's office sent out special people to call on all of those people to tell them that they're obligated to pay a tax, didn't they?

A. Yes, sir.

Q. And in fact, the Comptroller sent not one sole to any out of state magazine publishers to see what they were doing in Texas to make any investigation at all, did they?

A. Not to my knowledge, no, sir.

Q. You sent somebody to all of the newspaper publishers, didn't you?

A. There may have been someone in the department. I didn't send—the policy did not (p. 50) send anybody, but I think the Comptroller's department did, yes, sir.

Q. Your committee consisted of people from legal division, enforcement division and administration?

A. Yes, sir.

Q. And you were a member of the committee?

A. Yes, sir.

Q. And the committee's job was to implement the new sales tax—use tax?

A. Well, technically the committee's job was to set policy on the new taxes—not necessarily to make contact with those people, other than if they came in and asked us.

Q. Yes, ma'am, but part of that policy was to try to—to set the policy of how you were going about to implement it?

A. Yes, sir.

Q. That was part of the policy determinations of this committee?

A. Yes, sir.

Q. And the policy determination on implementation of the tax involved, for dry cleaners, extensive contact to encourage (p. 51) voluntary compliance and enforcement, didn't it?

A. After the Association for the Dry Cleaners had asked for a meeting with the policy committee, we did meet with them and give them some guidance, yes, sir.

Q. And you knew them—you set up the system or knew about a system to call on dry cleaners by the Comptroller's personnel?

A. That wasn't a policy decision, sir. That was from field operations.

Q. Yes, ma'am, I understand, but that was something that you became aware of, as part of that committee operation, as part of the policy of implementation of the tax, wasn't it?

A. Yes, sir, that's correct.

Q. And you understood the same system of implementation of the tax, as regards newspaper subscriptions. You went out and had people call on newspaper publishers and news boys and people that distribute them house to house, didn't you?

A. Yes, sir, after the Newspaper Association had been in touch with us.

Q. Yes, ma'am, and you did that for almost every other industry, didn't you, that (p. 52) came under the tax?

A. Field operations did, yes, sir.

Q. But you did nothing for magazines to encourage voluntary compliance for the people who are obligated to pay the tax?

A. To my knowledge, that's correct.

Q. Not a thing?

A. That's correct.

Q. And that was a part of the decisions of that policy committee that you sat on?

A. It may have been a policy decision by omission. I do not recall magazines being discussed by the policy committee at all.

Q. Okay. Now, in connection with the sale of magazines, you are aware that magazine people come to people's homes in this state soliciting orders for magazines, are you not?

A. Yes, sir.

Q. In fact, people have come to your home?

A. That is correct.

Q. And had a whole list of magazines?

A. Yes, sir.

Q. And the list included a lot more magazines than were published in Texas?

(p. 53) A. I would assume so; although, I don't remember reading the list, but they did have a list.

Q. And it was a long list—

A. Yes, sir.

Q. —of commonly national publications?

A. I would assume so, yes, sir.

Q. And you've known that was a practice in Texas as long as you've been with the Comptroller, haven't you?

A. That's correct.

Q. And you knew it when you sat on that policy committee?

A. Yes, sir.

Q. And you—and did you do anything to try to see that the magazines that were distributed nationally that had people in Texas going from house to house taking orders for those magazines, in fact, collected taxes from Texas subscribers?

A. No, sir.

Q. Now, you had a meeting with Mr. Gerhart, did you not?

A. Yes, sir.

Q. A couple of meetings?

(p. 54) A. Yes, sir.

Q. And about the time the tax was being implemented?

A. I think around that time, yes, sir.

Q. Okay, and Mr. Gerhart came to you with a list of organizations that he thought were selling magazines in Texas and that didn't—he didn't think paid taxes and offered you the names and addresses and opportunity to contact them and see if you could collect a tax from them, didn't he?

A. He did give us such a list, yes, sir.

Q. Okay, and that was in October or November of 1984, was it not?

A. Yes, sir.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 24 and 25 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what's been marked Plaintiff's Exhibits 24 and 25 and ask you if you can identify those, please, ma'am?

A. Yes, sir.

Q. What are they?

A. These are the two types of letters (p. 55) that we mailed out as a result of the list that Mr. Gerhart submitted to us.

Q. Now, you mailed that list out seven months after he brought it to—those letters out seven months after he brought you the list, did you not?

A. Yes, sir, that's about right.

Q. And you did that only after he had given a deposition, and you were about five days from your deposition in this case?

A. Yes, sir, that's correct.

MR. GEORGE: I'll offer Exhibits 24 and 25.

MR. MENDEZ: No objection.

QUESTIONS BY MR. GEORGE:

Q. Now, you had conversations with Mr. Gerhart and other members of this policy group or other people employed by the Comptroller's office in the fall of '84 about the practices of the industry, did you not?

A. Yes, sir.

Q. And you had conversations in which he reminded you of the door to door solicitations of magazine sales agents—solicitation agents?

(p. 56) A. Yes, sir, I think that was mainly the first meeting, but it could have been part of the second one also.

Q. All right, and in connection with that—those conversations, Mr. Gerhart told you that it was a common practice for magazines in this state—or magazines sold to residents of this state to have arrangements with school children and people going to school to go door to door to solicit orders for magazines?

A. Yes, sir.

Q. And gave you some names of the companies?

A. Yes, sir.

Q. That solicited the orders in Texas for magazines to be sold out of state?

A. Yes, sir.

Q. And you knew those names, and you did absolutely nothing to contact those people and see if Mr. Gerhart was right—whether they did solicit orders in Texas for the sale of magazines from out of state publications, didn't you?

A. I did nothing, that's correct.

Q. Did anybody at the Comptroller's (p. 57) office do anything?

A. Not to my knowledge, no, sir.

Q. You obviously knew you were doing nothing and did it anyway? I mean, you intentionally did nothing. It wasn't—nobody stopped you from doing it?

A. That's correct.

Q. You could have, if you chose in the course of your business, to pick up the phone and call Quality School Plans or TV Guide Plans or any of the other names—American School Plans or any of the others that Mr. Gerhart gave you names and ask them if they were taking orders for magazines out of state and verify the facts but you chose not to?

A. I called no one, that's correct.

Q. Nobody else did?

A. To my knowledge.

MR. MENDEZ: Your Honor, we've had some people enter the courtroom in the interim, and I'm not sure if they're witnesses or not.

THE COURT: All right. Any witnesses?

MR. MENDEZ: Thank you.

(p. 58) (At this time instruments were marked as Plaintiff's Exhibits Nos. 26 and 27 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what's been marked Plaintiff's Exhibit 26 and see if you can identify that, please?

A. Yes, sir, I recognize this.

Q. What is that?

A. That's an interoffice memorandum that I wrote after our meeting with Texas Monthly—our second meeting with Texas Monthly. It was addressed to Mr. Glen Castlebury.

Q. What was Mr. Castlebury's job at that time?

A. Associate Deputy Comptroller.

Q. In the hierarchy of the Comptroller's office, was he above you or below you?

A. Much above.

Q. Was he one of the senior people in the Comptroller's office?

A. Yes, sir, that's correct.

Q. One of the top two or three people?

A. Yes, sir.

(p. 59) Q. And during the meetings with Mr. Gerhart, had he given you some information about what he

thought revenue could be gotten from out of state publications that have people who take orders in Texas? We have some numbers in here.

A. I think there were some dollar figures given with the list of publishers, yes, sir.

Q. He had given you some calculations and said, "You can raise this money, and if you go out"—They have people taking orders in Texas, and if you go out and contact them, you can collect these taxes, didn't he?

A. Well, I think these were figures that he gave us that he thought amounted to Texas sales, yes, sir.

Q. Yes, of these companies?

A. Yes, sir.

Q. And then he told you about these companies, and you wrote the memo to Mr. Castlebury discussing what to do about it?

A. This memo was supposed to be the results of our meeting because Mr. Castlebury was not able to attend.

Q. And one of the references was the (p. 60) school fund raising projects where students sell magazine subscriptions?

A. Yes, sir, that's correct.

Q. And in connection with that you said, as a part of Exhibit 24—

MR. MENDEZ: 26.

QUESTIONS BY MR. GEORGE:

Q. —26, that you could try to call those people representatives, but you didn't think he wanted to?

A. Yes, sir, I made that statement.

Q. Okay, and it was because to do that—to treat these people as representatives of the magazines or the company would be politically unpopular; isn't that right?

A. I would not presume to think in Mr. Castlebury's shoes. I just got the distinct impression that he did not want to. Why he did not want to, I do not know.

Q. You remember testifying during your deposition about your belief that that was because of the political consequences of—

A. Yes, sir, I remember saying I did think it was my belief that that was the case, yes, sir.

(p. 61) Q. That it was because of his belief that it was politically unpalatable to treat these people and collect sales taxes—

A. Yes, sir, that was the feeling that I got from him, yes, sir.

MR. GEORGE: I'll offer Exhibit 26.

MR. MENDEZ: No objection.

THE COURT: All right. We'll take a 20-minute recess at this time.

(At this time a brief recess was taken, during which time an instrument was marked as Plaintiff's Exhibit No. 28 for identification, after which time the proceedings continued as follows:)

QUESTIONS BY MR. GEORGE:

Q. Ms. Hutcheson, have you ever been present during a conversation in which there was discussion about efforts to collect the use tax owed by Texas residents who use property purchased out of state that is subject to use tax?

A. Individuals or businesses?

Q. Well, individuals, yes, ma'am.

A. No, sir, I don't think so.

(p. 62) Q. Never been—in the 20 years you've been there, that's never been considered in any way how one could do that—at least encourage voluntary compliance?

A. Other than the publications that we put out to our permitted taxpayers, I know of no other way that we've tried to contact individuals.

Q. Now, it is the Comptroller's obligation to collect the taxes that are due the State that are enacted by the Legislature; isn't that right?

A. Yes, sir.

Q. And the Comptroller is obligated to collect the tax, whether he thinks it's a wise tax or not, isn't he?

A. Yes, sir.

Q. And it's obligated to collect all of the taxes that are levied by the Legislature?

A. Yes, sir.

Q. And it's, in fact, true, is it not, that for the 20 years you've been there the Comptroller has never tried to collect the taxes owed by consumers for use taxes on

products, including magazines purchased from out of state (p. 63) sellers, when the—at all?

A. Not in any way on a consistent basis or ongoing basis, no, sir.

Q. Have they done it on a spasmodic basis?

A. We may have collected from individuals again but only as they hold permits.

Q. And only businesses have got permits?

A. Individuals operating businesses yes, sir, as well as corporate businesses.

Q. But you've got to be in business to get a permit?

A. Yes, sir.

Q. And then the Comptroller, despite the Legislature mandating that these taxes be collected, has set up a system where they aren't collected?

A. From individuals, that's correct, yes, sir.

Q. And it's intentionally set up that system?

A. Well, we've set up the system to collect tax from permitted taxpayers. I don't know that it was intentional, but it's worked out that way.

(p. 64) Q. Well, you didn't—in 20 years nobody did anything to even try to set up a system to collect taxes for magazines or any other product but magazines for this lawsuit that are used by consumers in Texas?

A. That is correct.

Q. And you've been in the sales tax policy for 15 years?

A. Yes, sir.

Q. And you've never been privy to any discussion about even considering ways to do that?

A. That's correct.

Q. Would you have been privy to such conversations?

A. Yes, sir.

Q. If there had been any?

A. Yes, sir.

Q. Now, the taxes in Texas are not the same for every place, are they?

A. That's correct.

Q. I'll hand you what has been marked Exhibit No. 27 and ask you if you can identify that?

A. Yes, sir, that is our publication (p. 65) called Sales Tax Rates in Texas.

Q. And that's a publication put out by the Comptroller's office?

A. Yes, sir.

Q. And part of the sales tax policy or your group to oversee those publications—get them distributed when people call in; is that right?

A. Yes, sir, that's correct.

MR. GEORGE: I'll offer Exhibit 27.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, Exhibit 27 contains a list of five different tax rates; is that right?

A. Yes, sir.

Q. So that a taxpayer in Texas is subject to different taxes depending upon where they are when they use the product?

A. Yes, sir.

Q. So that if you live in Manchaca—is that what you—you live in Lockhart?

A. Lockhart, yes, sir.

Q. Is Lockhart in the MTA?

(p. 66) A. No, sir.

Q. In Austin?

A. No, sir.

Q. Okay, and if you use a product at your home—but it from out of the state and it's delivered to your house, you're subject to a different tax than if it's delivered to me in Austin?

A. That's correct.

Q. And what's your tax rates?

A. Four and an eighth State, one percent city, for a total of five and one-eighth.

Q. All right, and there are other places that have a half a percent MTA tax and no city tax?

A. Yes, sir, that's correct.

Q. And some places that have a one percent city tax—a one percent MTA tax and no city tax?

As and MTAs?

A. No, sir, cities are all a standard rate of one percent.

Q. Okay. So—but there's a combination of at least five different rates that are possible?

(p. 67) A. Yes, sir, I think five is correct.

Q. Okay. Now, are—when you use a product that is mailed to you at your house, you are subject to the five and an eighth tax; right?

A. That's correct.

Q. Now, if there is a taxpayer who subscribes to *Texas Monthly* and lives in Lockhart, what is their tax rate when they get the magazine?

A. I would suspect that that tax rate is going to be based upon where the publisher is located—not at point of delivery.

Q. Why?

A. Because it is a sales tax normally rather than a use tax.

Q. You have a policy that if something—body mails a—is it the sales tax policy of the State of Texas that if my client mails a magazine to Lockhart the resident in Lockhart pays a 6.125 percent tax because *Texas Monthly's* corporate headquarters are in Austin?

A. Except for the fact that there is an exemption for the MTA tax when the merchandise is mailed from outside

the authority—from inside the authority to outside the authority (p. 68) there is a MTA exemption for that. So the tax rate would be five and an eighth percent.

Q. Okay. That would be the applicable rate?

A. Yes, sir.

Q. Do you know whether or not my client has instructed that they have to collect the 6.125 percent from every Texas subscriber?

A. I don't know.

Q. You don't know that?

A. No, sir.

Q. Okay. Now, you're familiar with various exemptions from sales tax, are you not, ma'am?

A. Yes, sir.

Q. Among the exemptions are exemptions for fertilizer used on farms?

A. Yes, sir.

Q. And other miscellaneous things that are exempt from sales tax; is that correct?

A. That's correct.

Q. You're familiar with an exemption for products purchased by organizations for charitable purposes, are you not?

A. Yes, sir.

(p. 69) Q. Okay, and there is an exemption, is there not, for purchases by educational, religious and charitable organizations?

A. Purchases for their own use, yes, sir.

Q. Okay, but there is no general exemption for their sales?

A. Generally, no, sir.

Q. So that if the Boy Scouts sell things they have to—supposed to collect the tax?

A. With the exception of certain food products, yes, sir.

Q. And if the American Cancer Society which—is that a charitable organization that is exempt when they buy things?

A. Yes, sir.

Q. If they go out and sell things, they have to collect the tax just like exerybody else?

A. Yes, sir, with the exception of the limited exemption that they're entitled to.

Q. And that is for the purchase of goods?

A. The purchase of goods—they're exempt on the purchases, and they're exempt on (p. 70) their sales, if it's a religious, education or charitable organization, for one day. They can have a one-day, tax-free sale. Other than that, they're required to collect the sales tax.

Q. If they have a regular store—Goodwill Industries—

A. Yes, sir.

Q. —it may have an exemption on what it purchases?

THE COURT: Do garage sales have one-day exemption, too?

THE WITNESS: Generally no, sir. No, sir.

QUESTIONS BY MR. GEORGE:

Q. But Goodwill Industries, for example, has a store, and they sell things, and they're supposed to collect sales tax?

A. Yes, sir, they are.

Q. But when they buy things, they're exempt?

A. For their own use, yes, sir.

Q. Okay, and is it the Comptroller's obligation to make decisions on what is or is not exempt, who is exempt, what transactions are exempt?

(p. 71) A. Yes, sir.

Q. Okay, and do you inform—people contact you about exempt transactions?

A. Yes, sir.

Q. Okay, and I believe you've testified during your deposition that people have called you up and asked you about exemptions for religious periodicals?

A. Yes, sir.

Q. And that's something that they've asked you and you've read them the exemption, I believe you testified?

A. That's correct.

Q. And the exemption provides—and I won't quote it but, in essence, that periodicals published by a religious

faith consisting of the teachings of that faith are exempt; is that correct?

A. Yes, sir, I believe that's correct.

Q. And you have periodically informed people that there's such an exemption available, if they choose to use it?

A. Yes, sir.

Q. And I believe there is no system of applying for the exemption, is there?

(p. 72) A. No set procedure, that's correct.

Q. In other words, if somebody thinks they're exempt, they just don't pay the tax?

A. That's one way to do it, yes, sir.

Q. And that there is no system to submit a magazine to you to determine whether it's exempt or not, is there?

A. Other than just sending it in, no, sir.

Q. Has that happened?

A. Magazines, not to my knowledge.

Q. What's been sent in?

A. I think what is sent in normally is the organization itself will give us the name of what is being published and ask us if that particular publication qualifies for a sales tax exemption.

Q. And you decide?

A. No, sir. What we normally do is to see if the organization itself is a religious organization.

Q. And if the religious organization—anything they publish you let come out under that exemption?

A. What we tell them is we leave it to (p. 72) them to decide whether or not it's a religious—a publication or periodical that teaches their faith. We do not make that determination.

Q. Because there's no—you don't have any authority to make it in advance of somebody trying to collect the tax from them?

A. Well, I think it's mainly just because we don't want to get involved in deciding whether something is sacred to a religious faith or not.

Q. But if I go out and say I'm a religious faith and I want to publish a magazine that, I say, is sacred to me and I publish it, I don't have to come to you and get an exemption? I just start publishing it?

A. That's correct. After it's been established that you are, in fact, a religious organization, we do not pursue it any further.

Q. And if it's a religious—and you decide on whether it's religious or not?

A. Tax administration does, yes, sir.

Q. And that's something they look at what people say and how they act and what they do to determine whether they're, quote, a religious faith?

(p. 74) A. There are some guidelines that are set up to determine whether or not an organization is—qualifies as a religious organization.

Q. Ma'am, the exemption for religious organizations is Article—is now Section 151.310; right?

A. Yes, sir, I think so.

Q. And that's a different exemption than the exemption for religious publications, isn't it?

A. Yes, sir, it is.

Q. The religious publication exemption has nothing—doesn't say anything about a religious organization. It says a religious faith, doesn't it?

A. Yes, sir.

Q. And do you follow the statute when you're advising the public about that statute to say to them that it has to have—be published by a quote, religious faith and contain sacred teachings to be exempt?

A. Yes, sir.

Q. You advise them of the content of the exemption?

(p. 75) A. Yes, sir.

Q. When people talk to you about it?

A. That's correct.

Q. And you're aware that there are such publications in Texas?

A. Yes, sir.

Q. And they are exempt, or they don't pay the taxes. You know that, too?

A. Yes, sir.

Q. They don't have to come in and ask your permission to be exempt, but they just don't pay the taxes?

A. That's correct.

Q. Finally I'm going to hand you Exhibit No. 28 and ask if you can identify that?

A. This appears to be something that came off the Comptroller's computer. It looks like it's something that we ran by SIC code, Standard Industrial Classification code.

Q. Okay. I believe that was identified as Exhibit 14 of your deposition, which was—did you order up prior to your deposition a master record of the magazines that are published by Standard Industrial Classification?

A. Yes, sir.

(p. 76) Q. Okay.

A. This is what this appears to be.

Q. Okay, and there is a record in the Comptroller's computer of, at least, magazines that have some contact with the Comptroller that—businesses that say they are magazines, at least?

A. Yes, sir, that's correct.

Q. And Exhibit No. 28 is that list?

A. Yes, sir.

Q. And that is within the capacity of the Comptroller to generate a list of those magazines?

A. Yes, sir, it is.

Q. Okay, and there is a—on that I note an organization called the Baptist Standard. Are you familiar with that?

A. No, sir.

Q. Okay. Do you know whether or not they publish a religious periodical that is sacred to their faith?

A. No, sir, I would not know.

Q. You just don't know?

A. No, sir.

Q. But you're confident that there are such publications in the state?

(p. 77) A. Yes, sir, I am.

Q. And they don't pay taxes?

A. They do not pay taxes, that's correct.

MR. MENDEZ: Okay. I will agree to—or I will not object to the introduction of this exhibit, if we can cover it by a protective order, which I have been discussing with Mr. George here, and I have a motion and order.

MR. GEORGE: If the protective—you mean the identity that these people are?

MR. MENDEZ: Yes, sir.

MR. GEORGE: Let me see what the order exactly says, please. Excuse me, Your Honor.

MR. MENDEZ: And Your Honor, we have filed this motion, and I guess I should give it to you, if I may. Essentially what's happened is there is a taxpayer on that list which we won't name out in the open, but he's in one of those paragraphs, and I think it's on the second page,

and essentially that person has entered into an agreement with the (p. 78) Comptroller through a Multi-State Tax Compact, and one of the provisions of that agreement, which our lawyers at the Multi-State Tax Compact have agreed to, is that we would maintain the confidentiality of his name during the course of any trial that might occur, and Your Honor, this is the provision of confidentiality that applies.

MR. GEORGE: Your Honor, I—as long as it doesn't interfere with the orderly process of this lawsuit, I don't have any objection to the confidentiality order.

MR. MENDEZ: As long as you don't mention him by name and we talk about him, that's fine. I don't care but—

MR. GEORGE: We'll need a code phrase for this company, and the Court will need to be aware of that company's identity to examine witnesses.

THE COURT: Just call it A Company.

MR. GEORGE: Okay. You're aware of the identity of the company at this point?

THE COURT: Let me see. Where is it?

(p. 79) MR. MENDEZ: It's on that thing.

THE COURT: Okay.

MR. MENDEZ: And there's the order, Your Honor.

MR. GEORGE: And I have no objection to the order. Exhibit 28?

MR. MENDEZ: No objection under those conditions.

THE COURT: All right. Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, since July when you gave your deposition, Ms. Hutcheson, have you been privy to any conversations with anybody about finding organizations that solicit orders for magazines or making any investigation of out of state magazines--*Reader's Digest, Ladies' Home Journal,* anybody to determine whether or not they've got representatives in this state and ought to be collecting the tax from Texas readers?

A. No, sir.

Q. Have you been privy or are you aware of any effort to determine whether or not that (p. 80) would or would not produce any money for the State—any net receipts for the State?

A. I have no knowledge or have not discussed that in any way.

Q. Do you know if whether or not there has ever been any effort to determine whether simply a system of encouraging voluntary compliance of a few selective enforcement actions against consumers would induce consumers to pay use taxes that the Legislature has levied?

A. No, sir, I have no knowledge that that's been discussed or done.

Q. Do you know who the Comptroller is—knows whether or not that the system would—some system could not be set up that would produce net revenue, if uses taxes were collected?

A. No, sir. I have no knowledge in that area.

Q. There has been never any system set up, except for getting permits and processing returns from businesses; is that correct?

A. Yes, sir, to my knowledge that's the only way.

Q. That's it?

(p. 81) A. Yes, sir.

Q. And an inexpensive streamlined system for people to fill out and remit use taxes periodically under some system that would operate to collect taxes from people who read magazines where their home office isn't in Texas has never been investigated, looked at, thought about considered topside or bottom. Is that your testimony?

A. That's correct.

MR. GEORGE: Pass the witness.

MR. MENDEZ: Your Honor, we're going to reserve our questioning of this witness until we put on our case and reserve the right to recall her at that point in time.

THE COURT: All right. You may step down.

MR. GEORGE: We'll call Glen Castlebury.

MR. MENDEZ: He is outside of the room.

GLEN CASTLEBURY

was called as a witness and, having been (p. 82) previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Mr. Castlebury, you've previously been sworn, have you not?

A. Yes, sir.

Q. Would you state your full name and address for the record, please?

A. Glen Castlebury, 1611 Sunnyvale, Austin.

Q. Mr. Castlebury, you are an employee of the Comptroller of Public Accounts, are you not?

A. Right.

Q. And what's your position?

A. Associate Deputy Comptroller.

Q. And how long have you been employed by the Comptroller?

A. Ten years.

Q. And what are your areas of responsibility as Associate Deputy Comptroller?

A. Well, I have administrative jurisdiction over several divisions, including our Tax Publications Division, Research Division, (p. 83) Tax Information Division and Support Services Division.

Q. All right. Can you give the Court some idea of what the structure of the organizational chart of the Comptroller's office is? Mr. Bullock is the Comptroller, and who serves under him as his next in command?

A. The next in command is the constitutional office chief clerk. We call it Chief Deputy Comptroller, and that job is held by Mr. Jack Roberts. Under Mr. Roberts then there are eight, I believe it is, Associate Deputy Comptrollers, and underneath we eight Associate Deputy Comptrollers are spread out the various operating divisions of the office.

Q. Okay, and your duties include information to the public about the tax policies involving sales tax?

A. Right. Basically anything that goes out of our office to the public, whether it's a form or a policy announcement, a publication or—if it goes out to the public, then it comes across my desk.

Q. Have you been involved in discussions and policy decisions concerning the (p. 84) enforcement and collection of the sales and use tax for the ten years you've been employed by the Comptroller?

A. Yes, sir.

Q. Now, were you employed by the Comptroller in that position with responsibilities involving the implementation of the Legislative changes that became effective on October 2nd, 1984?

A. Yes, sir.

Q. Included adding magazines to the list of taxable items?

A. Yes, sir.

Q. Now, can you tell the Court what sort of efforts were made to inform the public regarding the need to remit and pay taxes for newspapers, for example?

A. Well, we contacted by direct mail every newspaper in the State of Texas and worked through their trade associations, Texas Daily Newspapers and Texas Press Association. I met with publishers across the state in several meetings.

Q. All right. Was there any effort to contact magazine publishers or magazine users, (p. 85) magazine readers?

A. No.

Q. Okay. Was there efforts to contact the dry cleaning industry that became subject to tax?

A. Yes, sir.

Q. Was there efforts to contact everybody else that became subject to tax except magazines?

A. Yes, sir, there was.

Q. And there was no policy, no effort to attempt to start collecting a tax on magazines, at all, was there?

A. Only as they were a part of the general public.

Q. All right. Now, one of the things in this case involves taxes on—the use tax. Do you understand that the tax—the use tax is levied on all users of taxable property?

A. Correct.

Q. And it doesn't matter whether you're a business user or a non-business user?

A. Correct.

Q. If you use an item that you didn't pay taxes on for some reason that is taxable (p. 86) you owe the tax?

A. Correct.

Q. And that if your wife goes off to New York and asks for a department store up there to send her something by mail or orders it by mail, she's obligated to pay taxes on that if it's a taxable item?

A. Correct.

Q. Now is it true that the Comptroller's office has never made any effort to collect the tax from Texas consumers for those use taxes?

A. For those use taxes, as you just described, that's correct. No effort has been made.

Q. Now, for magazine readers—you understand that people read magazinees, I take it?

A. Right.

Q. Do you read magazines?

A. Yes.

Q. Do you subscribe to some magazines?

A. Yes.

Q. Do you subscribe to some out of state magazines?

A. I have to assume it's out of state.

(p. 87) Q. Which one is that—*Reader's Digest* or—

A. *Southern Living, Sesame Street.*

Q. *Sesame Street*?

A. It's not mine. I read it to him, Judge.

Q. Do you remit a use tax on those products?

A. No, sir.

Q. Do you understand that a use tax is due?

A. Yes, sir.

Q. Is there an intentional policy on the part of the Comptroller's office not to collect use taxes from consumers on out of state magazines?

A. Yes, sir.

Q. And has there been discussions of the political impact it might have to enforce the use tax law as written? Have you ever sat down with Mr. Bullock and other Associate Deputies and said, "Now, what could we do to enforce this use tax as written, and what would be the political consequences?"

A. No, we have not. We've had members (p. 88) of the public in some instances talk to us about it, and in that situation we talked about—with them about the ludicrousness of the idea of trying to go into everybody's home and collect on their items.

Q. Well, the Legislature has passed this law that requires the collection of those taxes, hasn't it?

A. Correct.

Q. And the administrative officers simply decided that really isn't a particularly effective or a good way to do it and chose not to enforce it, haven't you?

A. That's about the way it comes down, yes.

Q. And you understand that the—that decision operates to discriminate against Texas magazines in this instance; that is, if my client publishes *Texas Monthly* here in Texas and your people come to their offices and make them pay them money out of their receipts for magazine sales, they have to pay it, but you read *Sesame Street* or the people who choose to read some other magazine don't pay it, and that discriminates against those readers and those (p. 89) businesses? The Comptroller is aware of that?

A. Yes, sir.

Q. And despite that, simply chose not to collect the tax?

A. That's correct.

Q. And Mr. Castlebury, it's true, is it not, that the Comptroller's office has never tried any system of investigating the economics of trying to collect the use tax to get people to voluntarily remit their use tax?

A. I wouldn't say that we've never tried to investigate it.

Q. Done any—

A. It doesn't seem like it requires a great deal of in-depth investigation.

Q. Well, there is—we used to have a system of voluntary rendering of property—of all kinds of property. Still do have a system of voluntary rendering of property subject to the local ad valorem taxes. It's a voluntary system of compliance. You're aware of that?

A. Right.

Q. And there are various publicity campaigns and other things that take place to get people to render their property on time and (p. 90) pay their taxes and that sort of thing. Has any system of encouraging voluntary rendering of use taxes ever—from our consumers ever been—"We could spend one million dollars on publicity and hope to generate a million dollars return" or any other kind of sit down with a pencil and a calculator and figure out—

A. True. Yes, because this is the basis of the audit program which becomes a basis of all voluntary tax compliance—that there is a—our audit program, which we'll do 25,000 audits this year, I believe, and in each audit a use tax would be picked up.

Q. But there's never been applying that—that's only businesses that get audited, aren't they?

A. That's true.

Q. And only the business—if you have a business, you get audited, but if you're a State employee or somebody else who doesn't have a sales tax permit and he's not in the business of selling anything or is not in business generally, you don't ever get audited?

A. That's right. If you're not in the business of selling—if you're not generally (p. 91) in the retail business and if you don't have a sales tax permit, no, you would not be audited.

Q. And there's no—and it's intentionally decided not to enforce the use tax against consumers?

A. Correct.

Q. Now—and no economic study has ever been done whether or not that's going to be a good thing for the State?

A. No, not in what terms, as I would understand, what you use with economic study, no.

Q. Okay. Now, has there been an effort to send people out to find publishers generally, ferret out folks that owe taxes and send them out—auditors out in the state looking for publishers in the state that might have to pay the taxes?

A. No.

Q. Now, you got a subpoena, did you not to come here?

A. Correct.

Q. Did you bring the documents that you were subpoenaed to bring?

A. Right. I brought the only document I found in my files that seemed to fit the (p. 92) description.

Q. Could I see those, please, sir?

A. Yes.

Q. Are these copies that we could mark?

A. Yes.

Q. You have an original?

A. Yes.

(At this time instruments were marked as Exhibits Nos. 29 and 30 for identification.)

QUESTIONS BY MR. GEORGE:

Q. Mr. Castlebury, there was—you had some meetings with Mr. Gerhart of *Texas Monthly*, didn't you, in the fall of 1984?

A. Correct.

Q. And he brought to your attention a list of publishers he believed had offices or sales people in Texas that were out of state people, did he not?

A. Correct.

Q. And did your office do anything to collect taxes from those people?

A. Not specifically.

Q. Did you take the list of people that Mr. Gerhart gave you and do anything with them (p. 93) at all?

A. I did not, no.

Q. Do you know if anybody else did?

A. I'm not aware that they did.

Q. Did Mr. Gerhart inform you that there were magazine order takers, solicitation people that went around from door to door taking orders for magazines?

A. Correct.

Q. And did he tell you that school children often did that?

A. He did.

Q. Did you get a memo regarding that from Ms. Wanda Hutcheson?

A. Right.

Q. Did you decide that the Comptroller would not do anything—this has been marked Exhibit 26 and is a copy of something you produced?

A. Right.

Q. You received Exhibit 26, did you not?

A. Right.

Q. Did you participate or make a decision not to take steps to try to collect the taxes from magazines that have door to door (p. 94) solicitors or use school children in Texas?

A. Correct.

Q. And what was the purpose of that decision? What was the reason for that decision?

A. Well, we just felt it would be absolutely absurd to go around to these youth groups—these children and people we didn't even know where they are or who they were or what they were doing.

Q. That you would—if you went out to the school kids and found out that *Reader's Digest* or other people were taking orders through those school kids, you could have gone to *Reader's Digest,* couldn't you, and seen if they had somebody taking orders here in Texas through Texas school children, but you chose not to do that?

A. Right.

Q. And you intentionally chose not to do that?

A. Correct.

Q. And you understand that hassling the school kids or other things might be controversial? I'll put it that way.

A. Well, it's not so much controversial; (p. 95) although, it certainly would be, but it would just be ludicrous. It's not at all in keeping with the way we run our office and the efficiency of how we raise the dollars we raise.

Q. And even though in this instance you're aware that the system produces discrimination against Texas publishers, you choose not to do it because it simply wouldn't be a good idea?

A. Correct.

Q. Now, I'll hand you what is Exhibit 29 and Exhibit 30 and ask you if you can tell the Court—those are items you produced in response to the subpoena; is that correct?

A. Right.

Q. Can you tell the Court what those are?

A. Exhibit 29 is a letter from Comptroller Bullock to Harry Gerhart of *Texas Monthly*, which the Comptroller issued following the meeting that Wanda Hutcheson and I had with Mr. Gerhart, and the Comptroller in this letter just simply announces that he is not going to take the liberty to rule the tax unconstitutional, and that he has asked the Attorney General that (p. 96) question, and we would just wait and see, and it has a line in there that says, "In the meantime we will expect to see magazines complying with required reports and payments as the newspaper industry is."

MR. GEORGE: I'll offer Exhibit No. 29.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. And what is Exhibit 30?

A. Exhibit 30 is no more than a weekly status report from one of our Associate Deputy Comptrollers at the time to Mr. Bullock, in which a reference was made on one page that Wanda Hutcheson and Mona Shoemate met with employees of *Texas Monthly* magazine about their assertion that the tax on magazine subscriptions is unfair to Texas. The Associate Deputy that wrote that didn't probably—maybe didn't know—I don't know whether I would inform Mr. Bullock about Wanda and Mona's meeting or not.

Q. Have you discussed that with Mr. Bullock himself?

A. Yes.

(p. 97) THE COURT: Has this one already been admitted?

MR. GEORGE: I'm sorry. I'll offer Exhibit 30.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, do you recall whether or not Mr. Gerhart supplied some numbers of his determination of what he thought could be raised in the way of revenue from out of state publishers?

A. Yes, he did.

Q. Okay. By the way, can you tell the—do you know how much the total dollars are raised from the sales and use tax, as it is now enforced in Texas for the last biennium or current biennium approximately?

A. Yeah, let me think a minute. Sales and use tax ought to bring in about 9 billion dollars this year.

THE COURT: Is this sales and use tax combined?

THE WITNESS: Yes, sir, Judge: If I'm right, it would be.

(p. 98) THE COURT: Is there any way of separating it out—from out of state, in other words?

THE WITNESS: Yes, sir, we know—we have a way—we know what we get from out of state, as compared to what we get from in state addresses, yes, sir.

QUESTIONS BY MR. GEORGE:

Q. Do you know what—when someone remits a sales or use tax, do they remit it as a sales tax or a use tax, or do they just remit it under the general statute?

A. The sales tax forms have one line for taxable sales, which is their sales tax. It has another line for use tax purchases—their purchases. So, yes, we can break it out.

Q. Okay. Do you keep—but your 9 billion dollars is the sum of what you sold that was taxable and collected from the buyer?

A. Right. If I'm correct on the number—and that bears checking, but the number I would have intended to use would have included both.

Q. Now, the total collected from magazines or that could—well, first of all, has the Comptroller done some sort of projection (p. 99) of what might be collected from magazines or newspapers or either one of those people?

A. Yes, sir, there was a quickie sort of off-the-cuff projection made in the waning days of the 1984 special legislative session.

Q. Is this a significant amount of money in terms of the budget of the State of Texas?

A. Not to the budget of the State of Texas.

Q. Now, in your subpoena there was a request for you to bring documents and correspondence and memorandum generated by the Comptroller's office relating to the collection of sales and use taxes from non-business consumers including but not limited to people who subscribe to magazines purchased by out of state publishers or from out of state publishers. Have you done that?

A. I had no documents to bring.

MR. GEORGE: Okay. I pass the witness.

MR. MENDEZ: We'll reserve our questions under the same criteria.

THE COURT: Well—

(p. 100) MR. MENDEZ: I'm going to put on a case when he rests, and I want to explain what the Comptroller's office does, and you know, I'll put on my witnesses so I can put on an orderly presentation is what I'm saying.

THE COURT: Well, I can understand that with your representative here, but are we going to do it on every Comptroller witness?

MR. MENDEZ: Well, I intended to, but, you know, if there's some problem with that—

THE COURT: Well, as long as it doesn't get out of hand, I guess.

MR. GEORGE: Your Honor, it's just a matter of timing. I don't want to take forever to try this lawsuit, but I don't mind him calling people back. If he wants to call Mr. Castlebury back, that's fine. If that's what he's saying, I don't have any—

MR. MENDEZ: That's what I'm saying is—

THE COURT: You can call him back.

MR. MENDEZ:—it doesn't (p. 101) bother us to do that, and so we'll be glad to do it that way.

THE COURT: If you're going to call him back just on your defense in chief, fine.

MR. GEORGE: I'm through with him, and he can be excused from the rule, as far as I'm concerned at this point, but that's up to Mr. Mendez.

MR. MENDEZ: Well, if he doesn't have any problem, he can stay through here. That's fine with me.

THE COURT: Now, of course, you can't use him again.

MR. MENDEZ: Oh, well, I thought he was—

MR. GEORGE: No, he can use him again, if he wishes to.

THE COURT: No, no, I'm talking about on the rule.

MR. GEORGE: I will waive the rule, as far as Mr. Castlebury. If Mr. Castlebury wishes to stay, I will waive it as for this one witness.

THE COURT: All right.

(p. 102) MR. MENDEZ: Do we want to have that same—for the rest of them—that I've got—you're going to call a bunch more of my witnesses, but as I understand, all of the rest of them will remain under the rule?

MR. GEORGE: I'll have to make that decision and see what you do, Mr. Mendez.

MR. MENDEZ: That's fine.

MR. GEORGE: I would like to call Mr. Glen Schankle.

GLEN SCHANKLE

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name—you have been sworn?

A. Yes.

Q. Would you state your name and address, please?

A. Glen Schankle.

Q. Mr. Schankle, what's your address?

(p. 103) A. 111 East 17th Street, LBJ State Office Building.

Q. And how are you employed, Mr. Schankle?

A. I beg your pardon?

Q. How are you employed? What's your job?

A. I'm Associate Deputy Comptroller for the Enforcement Division at the Comptroller's agency.

Q. And does the Associate Deputy Comptroller enforce—in charge of enforcement the person who goes out and enforces taxes against people who don't pay them voluntarily?

A. Does he actually do that? No, I administrate that.

Q. That's under your supervision?

A. Yes, sir.

Q. How long have you been employed by the Comptroller?

A. Nine years.

Q. And has your job with the Comptroller been in enforcement the whole time?

A. No, sir.

Q. Okay. How long have you been in (p. 104) enforcement?

A. Five months.

Q. And what were you before that?

A. I was Associate Deputy Comptroller of the Revenue Management Division.

Q. Have you, during your tenure as the supervisor of the Enforcement Division, supervised any effort to en-

force the use tax obligation on consumers to pay use taxes on products they buy from out of state?

A. I'm going to answer that in a way that—your question is really not clear to me.

Q. Do you want me to rephrase the question?

A. Yes, right.

Q. All right. Let's assume that a non-business person—my wife goes to New York, goes to a department store and orders some stuff and has it sent to her by mail. You understand she owes a use tax on those dresses; is that right? You have to answer verbally.

A. Yes, sir.

Q. Okay, and it's my understanding that the Comptroller has never gone out and tried to collect taxes from such people who buy things (p. 105) out of state?

A. From individuals?

Q. Yes, sir.

A. No, sir.

Q. You only do it if you have a—if you're a business and have a permit?

A. That's correct, sir.

Q. And you simply choose not to enforce the law the Legislature wrote?

A. No, that's not correct.

Q. Well, you could go out and enforce that law, couldn't you?

A. We could, yes.

Q. And you don't do it?

A. Well, not in that particular case, we don't do it.

Q. You don't do it as my wife or anybody else who buys from out of state—user—products from out of state, do you, unless they're a business?

A. Not correct.

Q. Do you enforce it against people who buy magazines from out of state?

A. No, sir. We do conduct random canvasses of the business community, which could (p. 106) pick up those individuals.

Q. For businesses again?

A. For the—

Q. Do you—do you subscribe to any magazines?

A. No, sir.

Q. Not one?

A. No, sir.

Q. Mr. Levy will be very—the owner of *Texas Monthly* is always sorry to hear about people who don't read magazines, but I hope you buy some from the newsstand. Do you know anybody who subscribes to magazines?

A. Yes, sir.

Q. Do they remit use taxes on out of state—

A. Not to my knowledge.

Q. And you know that?

A. Yes, sir.

Q. And despite knowing that, you don't do anything about it, although the Legislature has passed a law that said they have to do it?

A. No, sir.

Q. You just don't do it?

A. No, sir.

(p. 107) Q. Is there any other laws the Comptroller ignores?

A. Well, there is no laws that we ignore.

Q. You ignore the obligation for consumers to pay the use taxes on out of state magazines.

A. Well, that depends on how you value the collection of taxes.

Q. Yes, sir, but you—the Legislature made a decision that those transactions were taxable?

A. That's correct.

Q. And you have decided, in the wisdom of the Comptroller's office, to not honor—not go out and try to collect them and see what happened?

A. No, there was no decision made not to.

Q. You just don't do it?

A. When time allows, we will do it.

Q. And you've been there ten years, and it hasn't been done yet, has it?

A. Not to my knowledge.

Q. Do you have any plans of getting (p. 108) around to it sometime?

A. Not in the near future, no.

Q. You have never even discussed it have you, Mr. Schankle?

A. Randomly.

Q. Randomly discussed it?

A. Right.

Q. But you've never actually gone out and tried to collect the taxes at all, have you?

A. On the particular situation—

Q. On consumers who buy products?

A. No, sir.

Q. You know they're taxable, but you just ignore it?

A. Well, I'm not going to go for the word ignore.

Q. You just don't do anything about it?

A. Not at this time.

Q. Yes, sir. Okay. Now, have you ever had someone come to your home soliciting to sell you magazines?

A. Yes, sir.—

Q. Did you look at the magazines for which orders were being taken?

A. Yes, sir.

(p. 109) Q. The list? Lots of magazines on that list, weren't there?

A. That's correct.

Q. And they were asking you to order those magazines, weren't they?

A. That's correct.

Q. And they were asking you to order them from out of state?

A. That's correct probably.

Q. Okay. Did you do anything to go to those out of state publishers and make them pay taxes when they had an agent in Texas soliciting orders?

A. Well, the agent was, number one, unidentifiable in the particular situation that I'm thinking of.

Q. Unidentifiable? He was standing there in front of you at your door.

A. Yeah.

Q. And you knew he was taking orders for magazines to be sold to Texas residents and that you were a Texas resident?

A. It was a young kid or a teenager with a portable credit card pouch and a list of magazines. So I didn't feel it was necessary to (p. 110) investigate where he came from or who he was selling it for.

Q. Well, he opened up the brochure and showed you that there was Ladies Home Journal and all sorts of magazines on that list?

A. That's correct, and at that time I told him I wasn't interested.

Q. Yes, sir. Did you go back to your office and see whether those magazines were remitting sales tax for sales to Texas residents?

A. No, sir.

Q. In fact, you know they're not, don't you?

A. Not to my knowledge.

Q. Now, you haven't checked since this lawsuit came up to find out?

A. No, sir.

Q. Do you know if anybody has?

A. Not to my knowledge.

Q. Do you know whether magazines such as Reader's Digest and big ones like Reader's Digest and Ladies Home Journal and others are paying their taxes?

A. I'm familiar with a couple of cases I'm not familiar with the name of the magazine— (p. 111) just through hearsay—office talk I've heard where there have been some cases that magazines have remitted some tax.

Q. Some tax?

A. Yes.

Q. Now, are you aware of a representative of Texas Monthly bringing to the Comptroller a list of magazine publishers who circulate and sell magazines to Texas residents who have representatives in this state? Those magazines have representatives in this state, according to Texas Monthly at least, and who have solicitors in this state and told the Comptroller that those people have representatives and asked them to go out and try to collect the

taxes from these people—make them collect sales taxes from their readers?

A. No, sir, I'm not aware of that.

Q. Nobody has told you that?

A. No, sir.

Q. You're in charge of the Enforcement Division?

A. That is correct.

Q. Now, how would we go about getting the sales tax—obligation to collect sales tax (p. 112) enforced against out of state magazines? Would that have to go through you?

A. Yes, sir.

Q. So if the Comptroller decided that since Texas residents were ordering *Reader's Digest* or some other magazine through door to door solicitors that was enough to make *Reader's Digest* obligated to collect the tax from Texas residents, that would have had to have gone through you?

A. Technically, yes, but not all of the time, no.

Q. Well, you were in charge of the department that would do it?

A. That is correct.

Q. But it hasn't happened?

A. Not to my knowledge.

Q. Are you aware of any enforcement activities that have taken place to enforce other tax changes that took place—became the law on October 2nd, 1984?

A. Yes, sir.

Q. What has happened?

A. We've conducted canvasses once again of the business community to determine who those (p. 113) people are—to notify them.

Q. Who the people are? You mean, dry cleaners?

A. Dry cleaners.

Q. Massage parlors?

A. Massage parlors, dance halls.

Q. Turkish baths?

A. I beg your pardon?

Q. Turkish baths?

A. Yes, sir, along those lines.

Q. Pool halls?

A. Yes, sir.

Q. All of those people you've gone out and tried to collect the tax from?

A. Tried to collect the taxes, number one. Two, being to notify them that they do fall under the new tax law.

Q. Magazine readers you haven't done anything about?

A. Not to my knowledge, sir.

Q. And you knew you were't doing anything about it, and despite that, didn't do it at all; is that right?

A. Do you want to rephrase that, please?

Q. Well, you knew you weren't making (p. 114) any effort to collect the tax from magazine readers or magazine publishers who had some contact with Texas, except Texas based publishers like *Texas Monthly?*

A. Is that comparisons to the pool halls?

Q. Well, you went to pool halls. You sent somebody to the pool halls and told them to pay the tax, didn't you?

A. There was a purpose for doing pool halls or whatever, you know, you want to categorize those people as—not to do certain other areas.

Q. Well, somebody decided not to send somebody out to enforce the tax against magazine readers that read magazines from out of state publishers?

A. That is correct.

Q. And they didn't do it, but you did it for all of the other industries except this one; isn't that right?

A. Well, I'm not—no, that's not correct. I'm going to say that's not correct because there are probably some other areas out there where—automotive shops or whatever the (p. 115) case may be we may not have gotten around to, as well.

Q. Do you have any plans to get around to magazines?

A. Not in the near future.

Q. In fact, you don't have any plans near future or long-term future, do you?

A. Well, I can't answer that question.

Q. Well, you don't know of any, do you?

A. I can't answer that question. It depends on the time that we have to get around to concentrate on the magazine industry.

Q. You might get around to it some day, but you don't have any idea when that might be?

A. No, sir.

Q. All right. Did you get a subpoena to come here today?

A. Yes, sir.

Q. Did you look for the documents that were listed in the subpoena?

A. Yes, sir.

Q. The documents that were supposed to involve efforts by the Comptroller to collect taxes from out of state publishers and readers of the magazines published by out of state?

(p. 116) A. That is correct, sir.

Q. Did you look for those documents?

A. Yes, sir.

Q. Are there any such documents?

A. No, sir.

Q. Now, you understand that if you go about collecting taxes from the business community and you raid somebody's—send a bunch of enforcement officers down there and get some stories in the newspaper about the need to

pay taxes on pool halls that gets—encourages compliance, doesn't it?

A. That is correct.

Q. And you understand you don't have to go to every pool hall and raid them to encourage people to submit their tax returns?

A. That's correct.

Q. And despite knowing that you don't have to go to every consumer to encourage people to file their—to pay their use taxes on consumer products that they purchase and don't pay their taxes on them, you haven't done that at all, have you?

A. Could you run that by me again, please?

(p. 117) Q. Yes, sir. You know that if you enforce one or two times in a highly visible way the obligation to pay a tax against someone who's supposed to pay it, it encourages that person and others who hear about it to pay the tax?

A. That's correct.

Q. And you could do that against consumers who buy products subject to the use tax that don't pay the tax?

A. That's correct.

Q. But you choose not to?

A. We haven't.

Q. And has—are you familiar with any effort by the Comptroller to make any kind of organized decision about what sort of voluntary compliance, what sort of compli-

ance at all could be had to get consumers to pay use taxes on out of state publications?

A. No, sir.

Q. Do you understand that under the present system readers of *Texas Monthly*—part of what they send in has to be sent in for taxes, where people who read other magazines sent in from *Reader's Digest* don't pay the taxes?

(p. 118) A. Yes, sir.

Q. You know that's going on?

A. Yes, sir.

Q. And you don't do anything about it—haven't done anything about it?

A. Haven't.

Q. But you may do it someday?

A. May.

Q. If you get around to it?

A. That's correct.

MR. GEORGE: Pass the witness.

MR. MENDEZ: We have no questions for this witness.

THE COURT: You may step down.

THE COURT: If you've got something for five minutes, we can take it up. Otherwise, we can recess for a lunch break now.

MR. GEORGE: It won't be much more than five minutes.

THE COURT: All right. Let's try it.

MR. GEORGE: Dale Craymer.

THE COURT: Were you sworn (p. 119) earlier?

THE WITNESS: Yes, sir.

MR. MENDEZ: Well you were sworn for the deposition.

THE WITNESS: Oh, okay.

DALE CRAYMER

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. Dale Craymer, 4604 Elwood Road, Austin.

Q. And how are you employed?

A. I am the Director of Revenue Estimating for the State Comptroller.

Q. During the course of your work, have you had an opportunity to make an investigation, determined from the best evidence you can, which companies, if any, are paying sales taxes on magazine subscription sales?

A. Yes, I have.

(p. 120) Q. Was that done as part of your preparation for this case?

A. Yes, it was.

(At this time an instrument was marked as Plaintiff's Exhibit No. 31 for identification.)

QUESTIONS BY MR. GEORGE:

Q. Did you have an opportunity during that study to make an effort to determine approximately how much money you predicted would be collected from—under the current compliance system from all magazines that are collecting the tax and paying it?

A. How much we expected we were collecting, yes.

Q. Okay, I'll hand you what's been marked as Exhibit 31. Can you identify that?

A. Yes, it is—it was some information that I had prepared and had turned over to David Mendez concerning those publications—or the companies we expected had been remitting tax on magazine subscriptions.

MR. GEORGE: I'll offer Exhibit 31.

MR. MENDEZ: No objection.

(p. 121) THE COURT: Admitted.

QUESCTIONS BY MR. GEORGE:

Q. Now, Mr. Craymer, you are the person who is responsible for determining how much money is to be collected by the Comptroller's office from various kinds of taxes?

A. That's correct.

Q. That's your job?

A. Yes, sir.

Q. And you were also asked to determine how much money—or who was paying the sales and use tax on magazine sales?

A. Yes.

Q. And you instituted a procedure to do that?

A. Yes.

Q. And you came up with the list that's on Exhibit 31?

A. Yes.

Q. And that's all of the people you could find that were paying the tax?

A. That we—yes.

Q. And you used the best techniques you had available to you to do that?

A. Yes.

(p. 122) Q. All right, and you then set about the process of estimating what you think you were collecting from magazine sales tax payers, that is, publishers who are supposed to remit sales tax—or who are remitting sales tax? I rephrased that question.

A. Yes.

Q. And for the publishers who are remitting the sales tax, you have determined that approximately $1,400,000 a year is being remitted?

A. That was an earlier estimate. At the time of the deposition, I was asked to update that.

Q. Have you done so?

A. Yes, sir, I have.

Q. Is it different?

A. Yes, it is.

Q. What's the difference?

A. We estimate that it's approximately 2.5 million.

Q. You're changed your estimate?

A. Yes, sir.

Q. Have you got any more people paying the tax?

(p. 123) A. No, it is based on the same list of taxpayers.

Q. Okay. Same 20 or 30 people that are—companies that are on that list?

A. Yes, on the exhibit.

Q. Okay, and so you now estimate that those companies will remit—what—two—

A. We estimate that they have remitted 2.5 million for—

Q. Is that since October or—

A. Yes.

Q. Is that an annualized basis?

A. It's from October to August 31st, the first fiscal year the tax was in effect.

Q. Is your—are you estimating what they will remit on a fiscal year basis, or are you reporting what they did remit in the first—

A. I'm reporting what they did remit during the fiscal year 1985.

Q. Okay. Have you an estimate of what they will remit during a complete fiscal year?

A. I have not prepared one.

Q. Okay. So you don't know that?

A. Yeah. Well, you could make a reasonable assumption based on the nine months (p. 124) of information that we have.

Q. Somewhat more than the two—

A. 2.5, yes.

Q. —2.5. Okay, and you have done the best job you can in finding the people who are going to pay the tax—or who have paid the tax in the last year?

A. In identifying the ones that we believe, yes.

Q. I believe that you are a magazine reader; is that right?

A. Yes.

Q. And you read Texas Monthly, as I recall?

A. Well, parts of it, yes.

Q. Well, you subscribe to it?

A. Yes, I do.

Q. That's almost as important as reading, and you subscribe to other magazines?

A. Yes, I do.

Q. And you subscribe to out of state magazines?

A. I imagine some of them are.

Q. And you understand there's a use tax due on those subscriptions?

(p. 125) A. Yes, I do.

Q. And you don't pay it?

A. I do not have any—no, I do not pay it. If—I'm not sure which magazines I subscribe to are out of state. So I'm not sure exactly which ones I would be required to pay the tax on.

Q. Are you aware of any way you could pay it, if you wanted to pay it?

A. Well, occasionally on subscription flyers it will state that the subscription price includes sales tax.

Q. You've seen that?

A. Yes, I have.

Q. But you—I'm talking about an obligation to pay a use tax—your obligation to pay a use tax yourself to the State. You are the chief revenue estimator for the State of Texas, are you not?

A. Well, I'm director of Revenue Estimating.

Q. And do you know of any way that you as a citizen can, in fact, remit use tax when you buy something from out of state? Is there a procedure existent that you know of, as for a (p. 126) consumer to send in the use tax that he owes?

A. I have no direct knowledge of one, but I have heard that we do receive checks occasionally in revenue processing that just come in, and there is no stated purpose behind the check, and we expect that some of those are use tax checks.

Q. There may be some people who will send in because the Legislature has enacted a law that requires them to do so, but the Comptroller has not promulgated any system to collect it; is that right?

A. I do not have any direct knowledge of one.

MR. GEORGE: Pass the witness.

MR. MENDEZ: We'll reserve our questions.

THE COURT: All right. You may step down. Gentlemen, I have a brief 1:15 hearing, which should be complete at 1:30. So we'll recess this hearing until 1:30.

(At this time a lunch recess was taken, after which time the proceedings continued as follows:)

(p. 127) MR. GEORGE: Harold Lee.

THE COURT: You were sworn earlier?

THE WITNESS: Yes, sir.

HAROLD LEE

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Mr. Lee, would you state your name and address for the record, please?

A. My name is Harold Ray Lee. My business address is 111 East 17th Street, Austin, Texas.

Q. Are you an employee of the Comptroller of the State of Texas?

A. Yes, sir.

Q. And at the time you gave your deposition, you were head of the Audit Division; is that correct?

A. Director of the Audit Division, sir.

Q. Okay, and you have been, in the course of your career, head of the Enforcement (p. 128) Division, as well, have you not, sir?

A. Yes, sir.

Q. And is the Audit Division the division charged with going out and auditing a company to determine whether or not they are obligated to pay taxes or paid their right amount of taxes?

A. Yes, sir.

Q. How long have you been associated with the Audit Division?

A. Nearly 13 years.

Q. During that course of that time, does the Audit Division make a regular practice of auditing consumers who buy products that are not businesses?

A. Would you restate that, sir?

Q. I'll try. I don't have a sales tax permit, but I buy things. I'm a consumer, as you are. I assume you don't have a sales tax permit?

A. No, sir.

Q. But you do buy things?

A. Yes.

Q. And you become obligated to pay a use tax on some things?

(p. 129) A. Yes.

Q. And you are a consumer?

A. Yes.

Q. Have consumers, such as yourself, been audited in the 13 years you've been there?

A. No, sir.

Q. And have you intentionally not audited consumers?

A. No, sir. Well, yes, sir. Excuse me.

Q. You intended not to do that?

A. That's correct.

Q. And you are aware that the Legislature decided, in its wisdom, to have a tax—a use tax on consumers, as well as a use tax on businesses?

A. Yes, sir. If I could add, I think they also would want us to be expedient in the job we do and the collection of the taxes, and auditing all of the consumers such as myself would be pretty much cost prohibitive.

Q. Are you aware of the studies that—any studies ever been done of any—any way that could be implemented to try to get voluntary compliance from consumers who owe use (p. 130) taxes?

A. No, sir.

Q. No study has ever been done, have they, with the Comptroller?

A. I have no knowledge of that, sir.

Q. You make an assumption that there is no way to collect use taxes from even the wealthiest consumers and make no effort to do it, have you?

A. There is a program we're looking at right now that may address this issue. People bringing in things from foreign countries where we look at export declarations at the airports where we can key in on higher dollar volume—

Q. You're thinking—

A. —items.

Q. Excuse me.

A. Where we can key in on higher dollar volume items.

Q. You're thinking about doing that?

A. We have a—the right with the U.S. Customs to do it. We just have not been able to get our people into their facility yet.

Q. Haven't done it yet?

A. No, sir.

(p. 131) Q. Thinking about doing it to collect a use tax on consumers?

A. Looking at the feasibility of it, yes, sir.

Q. Okay, but that's the only inquiry that's ever been made, isn't it, sir, in the 13 years you've been associated with the Audit Division?

A. I've not always been in a management position with the Audit Division. In the last three or four years I don't know of any studies.

Q. Okay, and—

THE COURT: I have a question here.

MR. GEORGE: Certainly.

THE COURT: You're talking about import from foreign countries. You mean they've ordered it shipped into here or—

THE WITNESS: No, sir. It's coming in in their baggage.

THE COURT: Coming in their baggage? I guess I'm confused. How would that apply? Have I got to pay a—supposedly does the law require me to pay a tax, if I buy something while I'm traveling in England—a Texas (p. 132) tax?

MR. GEORGE: If you use it in Texas.

THE COURT: In other words, if I buy me a sweater in Scotland—

MR. GEORGE: The Legislature—

THE COURT: —and I come back and wear it here, I'm supposed to pay a tax.

MR. GEORGE: That's what the Legislature—

THE WITNESS: Yes.

QUESTIONS BY MR. GEORGE:

Q. That's what the Legislature has declared the law to be, isn't it?

A. Yes.

Q. That's the law in this state?

A. To my understanding, yes, sir.

Q. And that's so that anybody who uses—if you bought the sweater at Merritt, Schaefer & Brown, you're obligated to pay sales tax when you buy it to Mr. Merritt, Schaefer and Brown; is that correct?

A. Yes, sir.

Q. And if you buy it in Scotland and (p. 133) bring it back to the United States, you're obligated to pay—to Texas and store it or use it, you are obligated to pay a use tax?

A. From a foreign country, I don't know if they have a sales tax, but we would honor another state's reciprocal tax, if it was paid there and brought in.

Q. If you buy something in New York and you can show you paid their sales tax, if they have a sales tax, you can get a credit for the tax you paid in some other state?

A. That's correct.

Q. But subject to getting the credit you owe use taxes?

A. Yes.

Q. And that's the statutory obligation of every Texas resident?

A. Yes, sir.

Q. And the Comptroller has decided, in its wisdom that despite the statute it's not going to enforce that obligation?

A. I don't think we can with the manpower we have and the cost of it to do so.

Q. You think you have good reasons for not doing it, but you have decided not to (p. 134) enforce it—the statute?

A. Yes, sir.

Q. Okay, and you understand that that decision to not enforce it operates to discriminate against clients such as mine who mail things to Texas residents and they have their headquarters in Texas and compete with magazines mailed from New York to Texas residents?

A. Yes, sir, I understand there is a—some discrimination there.

Q. And that—the Legislature has enacted a statutory system that, if enforced, would not discriminate, but you choose not to enforce the statutory system because you don't think you can operate that way. It won't be effective. So you choose to operate the system in a discriminatory manner—the tax system?

A. Well, I think it would be ill advised to operate it where we spend more money than we collect.

Q. Yes, sir, but the Legislature has enacted the statute. For good or evil, that's the law is it not?

A. Yes, sir.

(p. 135) Q. And the law, if enforced and everybody paid the use tax they owed, would not discriminate, but you choose to enforce it in a way that you know discriminates?

A. I assume so.

THE COURT: The way—Counsel, it seems the way you're arguing—or the question is going, Counsel, is that the—all use tax would be unconstitutional?

MR. GEORGE: No, sir. If they have an obligation to pay the use tax on that sweater and they choose not to enforce it, that's an act on the part of the Comptroller to not enforce a valid law, and if they have an intentional plan not to enforce the law and it operates to hurt somebody under Article 8, Section 1 of the Texas Constitution, that's an unlawful plan or scheme to leave property off the tax roll just like the Duval County School Board—

THE COURT: All right. Then what's the ultimate effect of it?

MR. GEORGE: It discriminates against my client. It makes it harder for it to compete with its competitors (p. 136) who are sending magazines in here tax free that are not supposed to be tax free, but they decide they're not going to collect it, and that's what Article 8, Section 1 has outlawed, and if the Legislature thinks it's a—if it's a bad idea to have this tax, they ought to repeal it. If it's a good idea to have the tax, they ought to enforce it. The Comptroller, it's our position, doesn't have the authority to decide that it's a bad idea to enforce the—

THE COURT: What you're arguing is—I'm a little ahead of myself, I recognize, Counsel, but it helps me to think through as the evidence comes in—that, one you're not arguing that the tax itself is wrong.

MR. GEORGE: Not if—

THE COURT: It's the way in which it's being enforced?

MR. GEORGE: As applied under Article 1, Section 8—

THE COURT: Right.

MR. GEORGE: If it was enforced uniformly and collected uniformly, as regards Article 8, Section 1 of the Texas Constitution, our argument is it's—

(p. 137) THE COURT: You wouldn't be here, in other words?

MR. GEORGE: I might be here on the religious exemption or something else, but I would not be here claiming an unlawful plan or scheme to collect taxes, and I quite honestly understand that there are—there may be good management reasons to make a decision not to go after trying to collect some taxes. The cases in Texas—there was a good reason not to go after and try to collect money in bank accounts for ad valorem taxes. For years and years that was the statutory—the duty of tax authorities. If they chose not to do that, even though it would cost them a lot of money, it was unlawful, and our argument is this is exactly the same thing. You know, we repealed the tax on bank deposits as an ad valorem—as a—we amended the statute because we decided it was not a good idea.

Here the Comptroller has simply amended the law to the detriment of my client.

THE COURT: All right. Thank you.

QUESTIONS BY MR. GEORGE:

(p. 138) Q. Now, do you—are you aware of magazines from out of state that come into Texas and solicit orders—have people solicit orders for their magazine in Texas?

A. I have received personally things through the mail soliciting purchases of magazines.

Q. Are you aware of door to door salesman (sic) coming through the neighborhood saying they're working their way through school or raising money for the PTA or something and asking you to subscribe to *Reader's Digest* or *Ladies' Home Companion* or some other magazine?

A. I've been fortunate not to have been called on by those people.

Q. Are you aware that they exist?

A. I haven't seen any. Like I say, I personally have not been called on by them. So I really don't know if they are or not.

Q. Okay. Have you been given any list of organizations that are soliciting in Texas—any magazines that have solicitors in Texas and asked by any of your supervisors to go out and try to see if those people are selling magazines to Texas residents?

(p. 139) A. We have followed up on some leads of—more in the lines of book sales in the state.

Q. No magazine sales?

A. Not that I can recall.

Q. Okay. Do you have any knowledge of—well, let me ask it this way: Have you made any effort to try to determine whether or not particular magazines have representatives soliciting orders in Texas?

A. We have not looked at a particular magazine, no, sir.

Q. Okay. Do you audit magazine companies that have some contact with Texas, besides Texas based magazines, from time to time?

A. Yes, sir.

Q. And there is a company subject to a protective order that I'll call—and it's referenced in the protective order that you mentioned in your deposition, and don't say its name. We'll call it the ABC company for the purpose of this question—that you did audit?

A. I would like to go back to my deposition. We talked about two accounts there, one a parent and one a subsidiary. We audited the parent company, and the subsidiary company—(p. 140) I'm not sure whether it was audited, but we reached agreement with them.

Q. Did you audit the company that publishes a series of well-known magazines?

A. Yes.

Q. Did you determine that it did not have any contact with Texas and have to pay the tax?

A. No, that company does have offices here to my knowledge.

Q. You had testified in your deposition that they didn't?

A. I was speaking of the subsidiary company that we were working on.

Q. Okay. Did you make any efforts—have you made any efforts to go to magazines that are circulated in Texas and determine if they have agents out soliciting orders?

A. We have not gone to magazines that—per se. We are currently working with the Multi-State Tax Commission to audit companies that sell into Texas, and they will be—it will be a joint effort on the part of several states for paying some additional money to the multi-state compact. We feel they can represent (p. 141) our interests best in trying to determine nexus issues.

Q. In the 13 years you've been with the company—with the Comptroller there's—*Reader's Digest* sells a lot of magazines. You're aware of that, are yon not?

A. Yes, sir.

Q. Do you subscribe?

A. I'm not sure. I saw one at the house the other day, and I don't know where it came from.

Q. Okay. Was the use tax paid on that?

A. I don't know. I don't know where it came from.

Q. Okay. Did you—have you made any effort to determine whether or not they have solicitors soliciting—

A. Reader's Digest?

Q. Yes.

A. No, sir, I have not.

Q. Have you made any determination as to any company—any magazine company ever to try to find out if they have representatives in the state taking orders for their magazines?

A. I personally have not, no, sir.

(p. 142) Q. Now, you understand that if a company has sufficient contacts with the State of Texas it can be required to collect sales tax from Texas residents, even though it mails the magazine in from out of state?

A. Yes, sir.

Q. Okay, and you understand that it's within the power of the State of Texas to go to these companies and ask them to pay sales tax, if they have sufficient contact with the State of Texas?

A. Yes, sir.

Q. And you have auditors under your control that operate all over the country, do they not?

A. Yes, sir.

Q. You have offices in New York?

A. Yes, sir.

Q. And you could go from your office in New York or send somebody over to the publishing company offices and get their books and records and find out if they have anybody soliciting magazine sales in Texas in person going door to door in Texas?

A. That sounds very good, as you say it— (p. 143) that we have the authority, but if you go into a business located in New York City and they do not have an inventory here or an office here and all they may have is a salesman here and you say I'm from Texas—I'm from the Texas Comptroller's office and I want to see your records, you will probably be back with the Attorney General's office in the State of Texas getting in touch with the Attorney General's office in the State of New York so that that office can demand—they're just not going to throw open their arms and give us all of the records so we can go on a search and seizure look to see whether or not they have a salesman here. This is the reason we've opted to go with the multi-state group who will be auditing for various states and have more access to those records.

Q. But you haven't—in 13 years you haven't done it at all—hard or—I mean, you go out and audit people who are not cooperative all of the time, don't you?

A. This statute hasn't been in effect 13 years, sir.

Q. No. The sales tax?

(p. 144) A. The portion that brought the magazine under—

Q. Yes, sir, and you have audited—other companies have been under the sales tax for a long time, haven't they?

A. Yes, sir.

Q. And you've audited out of state a long time for sales tax compliance?

A. Yes, sir.

Q. For 20 years?

A. That's beyond my time.

Q. For 13 years anyway?

A. Yes, sir.

Q. That's right, and you have gone to companies that have not been cooperative, and you've forced them to comply, haven't you?

A. Yes, sir.

Q. And you have chosen for—to not go to any of these companies and force them to comply who sell magazines in Texas?

A. I think they will—the—if the—magazine companies or other companies in the future will have us knocking on their door through this contract we're working on.

Q. But you think you're going to make (p. 145) some agreement with some other states to do—to go out and audit these companies in the future? Is that what you're—

A. We have done audits of nexus issues in the past. We're opting for future audits in this area to use a different approach.

Q. Have you done it? We've had this tax for over a year.

MR. MENDEZ: Excuse me. Has he done what?

QUESTIONS BY MR. GEORGE:

Q. Gone out and audited a company who sells magazines in Texas to determine if they have salesmen here?

A. Not to my knowledge.

Q. And when do you plan to do it, if you're going to do it—in March, in June?

A. A magazine company, sir?

Q. Yes, sir. In December? When?

A. I don't have that plan, sir.

Q. There isn't any plan, is there?

A. There is a plan that—a contract we're working on with another group to work on nexus issues.

Q. When is this—this is a plan to (p. 146) make an agreement with some other states?

A. It's with the Multi-State Tax Commission, sir. It's a contract. They do audit work for us.

Q. And you're going to hire some people to do this?

A. Yes, sir.

Q. But you don't know when?

A. The contract is in the works right now.

Q. But you don't know when it's going to be done?

A. Not right off, no, sir.

MR. GEORGE: Pass the witness.

MR. MENDEZ: Your Honor, we'll reserve our questions.

MR. GEORGE: We'll call Harry Gerhart.

HARRY GERHART

was called as a witness and, having been previously duly sworn, testified as follows:

(p. 147) QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. I'm Harry Gerhart, and I live at 1614 Forest Trail in Austin.

Q. And how are you employed?

A. I'm the general manager of *Texas Monthly*.

Q. Can you tell the Court what *Texas Monthly* is—what kind of magazine it publishes?

A. Texas Monthly, Inc. is a company that publishes *Texas Monthly* magazine, which is a general interest consumer magazine that covers the State of Texas for general entertainment and information purposes.

Q. Now, could you tell the Court where *Texas Monthly* magazine is printed?

A. We print the magazine in Nashville, Tennessee.

Q. And can you tell the Court where the subscriptions that come in for *Texas Monthly* are processed and fulfilled?

A. The subscriptions we receive here we send to a company in Des Moines, Iowa that opens the letters and does the data processing to (p. 148) maintain our files, bill people, if we need to bill them, and on a monthly basis, send to our printer the labels that are used to address the magazines.

Q. Okay, and once the magazines are printed in Tennessee, how do they get to your subscribers in Austin, Texas?

A. The subscriber copies that are printed are presorted by postal areas and put on trucks contracted for by the printer, and they're delivered to either Dallas, Houston or Austin for entry into the postal system.

Q. Does Texas Monthly have any contact with these magazines when they leave the printer before they get to the subscriber?

A. No, we don't.

Q. And they're shipped on a common carrier from Nashville to Houston or Dallas or Austin, and then mailed by the post office?

A. That's correct.

Q. Now, can you explain to the Court how or what the relative economic importance of subscription revenue and advertising revenue is to the—to your product?

A. Yes, I can. The economic balance of (p. 149) the magazine is fairly simple, in that we produce material that we hope people will be willing to buy that's either informative or entertaining or a mixture of both and package it with good art and so forth for the purpose of getting them to either buy single copies or to subscribe for subscriptions annual or longer than annual subscriptions. The first and primary purpose is to provide quality material for these people to buy and the second purpose of getting them to buy it is so that we can sell advertising to advertisers who would like to reach those particular people in an effective way in an environment that is—supports or is friendly to their product and who will buy advertising in our magazine because their experience shows that our readers are re-

ceptive to their messages, and their advertising is effective in supporting their sales of their products or services.

The process by which we sell that advertising, which is the bulk of our revenue, is that we publish on an annual basis the number of paid copies we expect to deliver every issue during the year and more importantly, (p. 150) on an average through the year, we'll deliver that many copies. That is a common measure among advertising decision makers as to how effective their dollars are; that is, how many copies or how much are they paying per thousand copies that we're going to put out. We put out 280,000 copies each issue, and the advertisers have grown to be able to trust and expect that we will deliver that number of copies each issue and are willing therefore, to pay the price that we've asked them for that advertising.

We then have the challenge or job of finding on an ongoing basis new readers to replace those, who, because have either moved out of state or we've made them mad which we do periodically, choose to not renew their subscriptions or in some cases cancel their subscriptions. We have to on an ongoing basis every month acquire new subscribers so that we can continue to maintain that 280,000 base level.

Q. Mr. Gerhart, let me ask you of the total—

THE COURT: —sales tax—I mean, your sales across the newsstand?

(p. 151) THE WITNESS: Is included. It's included in that, yes, sir.

QUESTIONS BY MR. GEORGE:

Q. Now, in connection with your total revenue, is it 80/20 or 90/10 of the revenue that comes from advertising?

A. It's close to 80/20.

Q. Okay, and that you guarantee your advertisers that you'll deliver 280,000 paid copies; is that correct?

A. That's correct.

Q. Okay, and you—what percentage of your 280,000 paid copies are sold by subscription?

A. Approximately 83 percent. The other 17 are on the newsstand.

Q. Now, for clarity purposes, the sale on the newsstand of the magazine is—sales taxes are collected and remitted without problem; is that correct?

A. To my knowledge, they're collected by the retailer who makes the sale to the consumer.

Q. And that's the case for all other magazines sold on a newsstand; right?

(p. 152) A. That's correct.

Q. Whether they're published in Texas or anyplace else?

A. That's correct.

Q. The 83 percent of your subscribers or readers who buy through the mail are the focus of what our controversy is about; is that correct?

A. Yes, sir.

Q. All right. Now, in connection with the acquisition of or maintaining 280,000 paying readers, what do you have to do to do that, or how do you go about doing that?

A. Insofar as we're attempting to maintain that level by acquiring new subscribers we have basically four—maybe five ongoing techniques that we use. The first and the most significant one, because it's the one that we can use on an ongoing basis and control or predict performance, is the use of direct mail solicitations where we mail packages. We call them packages. They typically have a number of items together, and they're really just a direct mail cold solicitation asking the person to subscribe to our magazine.

(p. 153) Q. Are you familiar with other magazines that mail into Texas similar solicitations?

A. I am.

Q. Are they mailed in to Texas residents—wherever they're put into the postal service, mailed to Texas residents by national magazines that are not based here?

A. Virtually every magazine in the country does it.

Q. Okay, and do your operations differ in any material way from the way they do it?

A. No material way, except that we mail almost exclusively just to Texas residents and they may mail their national publication to people around the country.

Q. Okay. Now, what are the other ways to get subscribers—mail-order subscribers to your magazine?

A. We will from time to time, run some commercials on television that promote the sale of the magazine and often in that context use a 1-800 number that people can pick up their telephone and call in. We insert in copies that we sell on the newsstand and in copies that (p. 154) we send to current subscribers, what we call bind-in cards. They're cards—little mail—self-mailer cards that are bound in the magazine that we hope people who pick up the magazine and are interested will tear out and mail back to us, and we participate from time to time in the use of agents to acquire subscriptions for us.

Q. Now, what—can you describe the kind of agents you're talking about? Now, these are people who take orders for you?

A. They're in every case people who use their own marketing scheme, and they're varied in different marketing schemes to get consumers to purchase—choose our magazine or anybody else's magazine and purchase those magazines. They receive the order and transfer to our fulfillment company in Des Moines the name and address of the person who has ordered the magazine plus whatever appropriate amount of money we've agreed they will refund to us.

Q. Do any of these magazine agents that you call them that take orders for you have people who go in person in Texas from house to house or from business to business and ask them to give them an order for *Texas Monthly*?

(p. 155) A. One of the ones that we use uses predominantly fund raising projects used typically by schools to—as a way of soliciting orders; that is to say, the end result is that school children, band members, glee club mem-

bers will go block to block, house to house soliciting subscriptions from the residents, and we use those types of agencies periodically.

Q. Now, they take the—an order and send it to Des Moines, Iowa, who then processes it, gets it printed in Tennessee and ships it to the postal service and delivers it to Texas residents?

A. That's fundamentally the process that—the exact sequence of how the school child does what, I'm not familiar with.

Q. For the record, these agents are not buying your product and reselling it, are they?

A. That is correct. They are not.

Q. They are soliciting orders for your product?

A. That's correct.

Q. Now, you've named the direct mail which you said was common, on the basis of what (p. 156) you know for all magazines, national or otherwise, in contacting Texas residents and soliciting subscriptions. Are the other methods you've named—the television, agents, insert orders in the magazine itself—also typical of all magazines?

A. They're all typical of magazines. If there's one that may have—not be universally used, it would be the television. Some magazines simply aren't large enough for that to be a productive technique for them, but all use insert cards that I've ever seen, and as you can know from PCH postage stamp response things, lots and lots use agents.

MR. GEORGE: I'll mark a copy of your product as Exhibit 32—Plaintiff's Exhibit—is it 32?

(At this time the instrument referred to was marked as Plaintiff's Exhibit No. 32 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what is marked as Plaintiff's Exhibit 32 and ask you if you can identify that?

A. This is a copy of the February 1986 (p. 157) issue of Texas Monthly.

MR. GEORGE: I'll offer Exhibit 32.

MR. MENDEZ: No objection.

THE COURT: Admitted. Shall I take time to read it now?

MR. GEORGE: Why don't you listen to this, and this evening you can take that exhibit home and enjoy it.

THE WITNESS: Maybe I should identify it as our bum steer issue.

QUESTIONS BY MR. GEORGE:

Q. In connection with the number of subscribers that you have, is there some methodology existent for verifying what you tell your advertisers—that you, in fact, have 280,000 people who subscribe to your magazine or read your magazine?

A. Yes, there is.

Q. And can you tell the Court how that works?

A. Some time back advertising agencies and newspaper and magazine publishers, in an attempt to clarify

who was really doing what they said they would do and who wasn't, formed (p. 158) an organization called the Audit Bureau of Circulation, and it's an industry supported, multi-armed supported audit system. Magazines that choose to tell the truth belong to this organization, and the organization sets forth a set of rules by which you can qualify—have your copies qualify for what is called paid circulation. It specifies how much of your full price must be paid for it to count, and it provides for an assessment of dues so that it can support an audit—a field force that routinely audits all of the members.

Members traditionally submit semi-annually their own report in the format specified by the bureau claiming or stating what their circulation is, and on an annual basis the field auditors of ABC then audit two—or the previous years' two reports. That involves, first, for those magazines that—whose subscription processing or what we call fulfillment is done at the larger major data processing firms, ABC has resident auditors who on an ongoing basis are sampling all of the order processed by that house so that the standard order is verified by a standard (p. 159) sampling system. They then annually come out and verify, with—by looking at our bank deposits and our reports and the checks we wrote that we received money for the newsstand copies that we claimed and tie that, in an audit sense, to the number of copies we say we sold, and they check our printing bills to make sure that we paid somebody to print the number that is necessary to have the number we say, and they check our postage statements to make sure that we paid enough postage to have mailed them, and they issue a report that says, in essence, whether

or not their audit of our statements showed any material discrepancy.

That is done by newspapers and magazines who belong—or done for newspapers and magazines that belong to ABC, and that's the technique that we use. It's the one that's used by most substantive consumer magazines in the country.

Q. Are there—the reports on how much the circulation for *Reader's Digest* and *People* or *Good Housekeeping* or *Cosmopolitan* or any of those magazines available from this source to anybody who wants to look it up?

(p. 160) A. They are. They publish—they reproduce the statements filed by each publisher every six months on what are called pink sheets. They're large, ledger-sized sheets, and those sheets are generally available through ABC to anyone who wants them. Usually most advertising agencies and magazines have a set of their own.

Q. Okay, and if the Comptroller wanted to know what magazines were being circulated or sold to Texas subscribers by *Cosmopolitan* or somebody, they could go to the ABC data base and figure it out; is that correct?

A. They certainly could, yes.

Q. And these's no particular difficulty from that, if they choose to go do that?

A. Not that I would ever be aware of, no. They could come to Texas Monthly, and we could tell them.

Q. In fact, you went to meetings with a Comptroller in the fall of 1984 and tried to explain the livery system of Texas—out of state magazines into Texas, did you not?

A. Yes, we did.

Q. And that they were being sold in Texas by agents who solicited orders in Texas, (p. 161) did you not?

A. We did.

Q. And offered lists of addresses and data for the Comptroller to go out and get these people to collect taxes?

A. We did.

Q. And now focusing on the collection of—putting aside the problem of the consumer who owes a use tax and doesn't pay it—putting that aside and away from this consideration and focusing upon the collection of sales tax only for the purpose of this argument, the—you went to the Comptroller's office and gave them a list of names of publishers—

MR. MENDEZ: Well, Your Honor, if—I'll object because I think it's a leading question. Why don't we just let him answer what he gave the Comptroller's office and—

THE COURT: What's your objection again?

MR. MENDEZ: Leading question.

THE COURT: All right.

QUESTIONS BY MR. GEORGE:

Q. Let me finish the question. Then (p. 162) I'll be happy to rephrase it. Tell the Court what you did in con-

nection with giving the Comptroller a list of names and who they were.

A. I took a list—actually I think we delivered two different times two different size lists, but I took lists of magazines that we believed had sales offices in the State of Texas. That particular list comprised approximately 20 magazines who from our information had advertising sales people—employees who were officed in either Dallas, Houston or Austin. I took that list to the Comptroller's office and asked him to—if he would—could check and see if they had sales tax permits. Of the list of 20, three showed up as having sales tax permits. 17 didn't. I gave them that list, as well as the names of some agents who operate in the state selling subscriptions.

Q. Are these the people who solicit orders for—

A. Yes.

Q. Okay. Including for your company?

A. Yes, that's correct. Secondly, we also provided a list, I believe at a different point in time, of magazines who had substantive (p. 163) circulation in Texas, my definition of that being, I think, in excess of a thousand subscribers. I have frankly forgotten how many there were—an excess maybe of a hundred. Maybe it was 50 or a hundred magazines who were published—whose home offices were listed in ABC records as being out of the State of Texas but who—because of the size of circulation in the state, it was evident that some significant degree of agent acquisition would have taken place on their behalf in the state. Those were the two sets of lists, and I actually took that other one just at his request of who

were people who would—who might be—might have nexus and might ought to be approached for the purpose of collecting sales tax.

Q. Okay, and this is—now, do you have an understanding of whether or not out of state publications do collect taxes from Texas residents that they sell their magazine to?

A. I have no personal knowledge of any publisher who collects sales tax who's out of state, and my understanding is no one tries.

Q. Okay. Now, let me ask you if the collection of sales tax—well, first, before I (p. 164) forget it, I believe the other day somebody came to your house selling magazines door to door?

A. They did.

Q. And taking orders?

A. They did.

Q. Okay, and were they selling a whole bunch of magazines—a national list?

A. A whole raft of them.

Q. All of the major titles—*Reader's Digest, Time, Life,* et cetera, et cetera?

A. Yes, yes.

Q. Okay. Did your family order one?

A. We did mainly to get the guy to leave.

(At this time an instrument was marked as Plaintiff's Exhibit No. 33 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what has been marked Exhibit No. 33 and ask you if that's the order that was—

A. That's our copy of the order, yes.

Q. Okay, and are you familiar with a publication called *Science '85* or *Science* magazine?

(p. 165) A. I am, yes, indeed.

Q. And you're going to get more familiar with it?

A. We hope so, if they ever come.

MR. GEORGE: I'll offer Exhibt No. 33.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, that publication's offices are not in Texas; is that right?

A. That's correct. They are not.

Q. And they have an agent in Texas soliciting orders for them, do they not?

A. They have at least two because two days later another guy came by.

Q. Okay, and did they collect sales tax from you?

A. They did not.

Q. Now, does your company compete in any way with a magazine like *Science* magazine?

A. Very much so.

Q. Can you explain to the Court how that operates?

A. Well, the essence of the magazine (p. 166) business, unlike many other businesses, is that we're all competing for one precious commodity, the reader's time. That's the first and fundamental thing that we're all competing against each other for. All else follows. If we can convince that reader to spend the time to read the magazine, whether it's for information or for entertainment or whatever else, then we have commanded his attention, which allows both the editorial quality of the magazine, that is, the thing we're trying to sell to him, to come through and allows any messages of our advertisers to have some impact on them, too, but in everybody's normal lifetime they choose—they have the time they have to spend doing what they have to do, and they have the time to spend to do what they want to do, and we compete in a broad sense with a lot of different things for that free time, but in a specific sense for whatever reading time that they're willing to commit, we're in competition with virtually all other magazines, and in a specific sense some people will have a special interest, such as tennis, and they'll make some commitment of time specially to that interest, and then that means (p. 167) we're competing with all of the other general magazines for the remaining reading time that they have. So in a very real sense, we compete with all magazines or all general interests and non-mandatory reading.

Q. All right. Now, does the payment of the tax by your company and the non-payment of the tax by *Science '85* or *Reader's Digest* affect yuor company in any way?

A. It has a very fundamental effect in the long run.

Q. Will you explain that to the Court?

A. Not just to our magazine but ultimately to the readers themselves. The nature of our business is that we're unable to collect this tax from anybody else; therefore, this tax becomes an expense to our company and in our case a fairly significant expense in just a very direct sense. Now, to the extent that other companies who are competing for time don't have a similar expense—and for instance, in *Science '85*'s case that's very much the case. It simply means that over time they have that much more resource to devote in a competitive sense to the quality of their magazine than we (p. 168) do, and since it is the quality of the magazine that in the end makes this whole system work—makes it an appealing product for the reader to read the first time and to continue to read because he enjoys it, in the end our economics fundamentally are materially impacted by that disadvantage, and the reader is impacted in that the reading material in the end isn't what it could be, if we didn't have that disadvantage.

THE COURT: What are you saying? You mean with the money that you saved you could hire a writer that might end up being more—

THE WITNESS: That's an exact recent occurrence or put more color in it.

QUESTIONS BY MR. GEORGE:

Q. Let me ask you, in connection with this *Science* subscription, by the way, to tell the Court the relationship between that first order in the magazine industry and the renewal of that industry—how that would work for your company?

A. One of the phenomena, as I said earlier, that we're trying to do is we're trying to convince a new reader to try us under the (p. 169) belief that they'll enjoy us, and the marketing hurdle that we have inducing that first purchase is very significant compared to the hurdle that we have after a person has taken us for a year to continue to take us. We, in fact, have a good renewal rate—a very good renewal rate.

The economics are that we spend--gosh, I can't even tell you how much, but multiples in terms of promotional expense to secure the first reader compared to the amount of money that we spend to induce a current subscriber to renew, and in fact, after someone has read us for two years, we have to spend almost no money at all to--we just have to essentially offer them the opportunity to renew their subscription again and they do, the net result being that from the—from a profit and loss standpoint, it's in the third year of a person's subscribing to *Texas Monthly* that we finally make—begin to make money enough to help pay for the printing of that magazine itself. The first two years—

Q. Off the subscription itself?

A. Off the subscription itself.

Q. Could you tell the Court what the—(p. 170) from the companies you deal with, the ratio of the Commission is paid for those order solicitors generally that come door to door for your company?

A. Agents—field agents typically remit or send on to the publisher between eight and 12 percent of the purchase price.

Q. 90 percent is paid as commission?

A. 90 percent is retained by them as commission.

MR. MENDEZ: Before he goes on, I'm not sure to object or not. Did you mean that that was Texas Monthly's experience—that's what they remit to these agents for soliciting? Is that your testimony?

THE WITNESS: That's what we remit—it's my testimony that we remit in that range and that other magazines as well—

MR. MENDEZ: I'll object to that question to the extent that it calls for his opinion of what other magazines that he hasn't been called for—on or shown any experience on—that he's relating it—

THE COURT: All right. I'll sustain it at this point.

(p. 171) MR. MENDEZ: Thank you.

QUESTIONS BY MR. GEORGE:

Q. Now, in connection with your company, Mr. Gerhart, is the willingness of your company to pay 90 percent commission for that first order related in any way to the opportunity to get renewals?

A. Well, it's related entirely—I mean, our willingness to pay anything for any—because we pay, one way or the other, for all first time subscribers—is clearly for an opportunity to renew that reader and to renew them again after that, if we can.

Q. And so that person coming door to door is kind of a get the foot in the door system; is that right?

A. Absolutely, yes.

Q. Okay. Now, can you—

THE COURT: Let me ask you this: Sometimes when they come door to door, they are not only—well, I would tell them I already subscribe to that. "Well, but you can renew it through us." Does the renewal work the same way?

THE WITNESS: Well, it (p. 172) works—from your viewpoint, it works the same way, in that they'll process that order, and when your current order would otherwise end, it would continue. From the publisher's standpoint, it doesn't work the same way, in that he gets ten percent of what he woul have gotten otherwise, but there's nothing he can do about it. He's certainly not going to tell you, "Sorry."

QUESTIONS BY MR. GEORGE:

Q. Now, can you explain to the Court now—what Texas Monthly does to remit the sales tax that's paid under protest?

A. Yes, sir. We send—first, I'll start off by saying that we send all of our mail orders and payments. We receive them in Austin. We count them for the purpose of having a volume count. We box them up, and we send

them the same day to the fulfillment house in Des Moine, Iowa. They cashier the material; that is, they make proper records—a receipt of all of the money, and then they deposit it in a bank account of ours in a bank in Des Moine, and we the following day, transfer that money back to our —here in Texas to our account. At the end of the month, for the month in question, our (p. 173) accounting staff takes the cash receipts in that bank account, and that bank account is notated the deposits which were for subscriptions and what small amount could be for any other item and using—uses that report of money received to calculate the amount of taxable sales that we report on our monthly sales and use tax report. Do you want me to explain the rest of that computation?

Q. Yeah, how do you compute the amount to send in?

A. Okay. The issue—well, first, we begin with an amount of money—gross amount of money deposited in the account. We take the distribution of subscription copies mailed during that same month, and we get quantities mailed by zip code from our computer system so that we can know exactly what the fractional percent that were mailed into the State of Texas are. We apply that percentage for that month to those deposits and the—to determine what we consider to be the in-state sales for that month. That amount of money is then added to the—well, for the line that says gross sales, is added to the amount of receipts that we received (p. 174) for newsstand sales. While they're not taxable, they're reported on that line, as well as the amount of money that we received in our office that month where individuals walked in and asked for copies of, you know, the December issue

or something like that. All other taxable sales, in other words, that we have—that sum is reported as gross revenue. Then the next line, gross taxable sales, is that amount backing out the newsstand receipts because they're not taxable, and the next line in the form—

Q. Not taxable in the sense that the retailer collects the tax?

A. That's correct.

Q. Collects the tax?

A. That's correct. They're exempt because they were sold for resale. We then compute the use—the value of the—of items that are subject to use tax. The taxable sales plus the use tax quantity is added up, and we pay six and an eighth percent of that to the Comptroller.

Q. Okay. Now, do you—are you aware that there are varying tax rates in this state depending on where you live?

(p. 175) A. Very much.

Q. Okay, and as I take it, your magazine is shipped out of Nashville, Tennessee?

A. That's correct.

Q. By a common carrier, then the post office to people in Texas; is that correct?

A. That's correct.

Q. And do you have any way to determine what—or collect or remit the tax for the person who lives at Buda

and is not in the MTA but the person who lives in West Austin who is and owes both the MTA and the other tax? Do you have a system for doing that?

A. We don't, no.

Q. Is there a way you could do that?

A. Well, it could be done hypothetically, if we were able to get our fulfillment house—the computer company that keeps track of our readers to modify their system. Your Honor, we keep track of every individual reader and each of his subscriptions so that we can tell when it should start and when it should stop, what he paid for it, whether he paid for it in cash or whether we have to bill him, and those are called trailers, (p. 176) and we keep them on a massive computer—or this company does. So all of that information is kept on a discreet basis, with the result that if you were to cancel that subscription that you were talking about you would get back the remaining portion of what you'd paid them—not what you'd paid on the previous one, for instance. We get—all of that information is discreet. Now, that computer system at our fulfillment house and at all of the others in the nation currently don't have the capacity to handle sales tax, but were they to and were the comptroller to be able to provide us with, on an updated basis, the current tax rates by zip code, then hypothetically we could pay the tax based on what the weighted average was.

Q. Is there any way to do it now?

A. No.

MR. MENDEZ: I think I want to object again, Your Honor, but I'm not sure what he was testifying to halfway

through that question. Did you say that you had knowledge about the way that other computer systems are set up for other types of magazines that are sold throughout the United States?

(p. 177) THE WITNESS: I did.

MR. MENDEZ: Okay, I'll move to strike that portion. I'll object to that as being hearsay. He hasn't shown any testimony here as to knowing what those computer systems are set up to do or not to do.

THE COURT: He just said he did. Now, if you want to take him on voir dire to find out—

MR. MENDEZ: Sure.

THE COURT: —where that comes from, I'll permit you to.

MR. MENDEZ:: Thank you, Your Honor. May I?

THE COURT: Sure.

VOIR DIRE EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Gerhart, which corporations, other than your fulfillment house, maintain computer programs that account for subscription receipts?

A. The other one that I'm familiar with is Neodata in Boulder, Colorado.

Q. How do you spell that again?

(p. 178) A. N-e-o-d-a-t-a.

Q. Okay, and do you have a contract with that corporation?

A. Not at the present time.

Q. Okay. Have you ever had a contract?

A. We have.

Q. Okay. When was that?

A. From the inception of the magazine until approximately two years ago.

Q. Okay, and in the course—were you the general manager during this period of time?

A. I was.

Q. Okay, and in the course of your negotiations with them, did they explain to you how they accounted for taxes?

A. They did.

Q. Okay, and do you know if they still maintain that program at this date?

A. They never accounted for taxes at that time.

Q. Do you know if the program that they're using at Neodata today is identical to the one that is being used by your fulfillment house in Iowa?

A. It is not identical.

(p. 179) Q. Okay, and can you identify for us what the name of the computer is or the program is that accounts for these subscription sales by Neodata?

A. Well, I know the hardware is IBM. I have no idea—in fact, they write their own software.

Q. Okay. Who's the computer software writer?

A. Well, the head of the department, I believe, is a gentleman named Gary Smith.

Q. Okay, and when did you last communicate with Mr. Smith?

A. I guess about a year ago.

Q. Okay, and did you ask him about how they accounted for taxes on their system at this time?

A. I did not.

Q. Okay, and have you had an occasion to contact that corporation in the last year since this lawsuit has been going on?

A. No, I haven't.

Q. And could they have changed their computer program to use some different program in the interim?

(p. 180) A. Not without me knowing about it.

MR. MENDEZ:: Okay. I withdraw my objection.

DIRECT EXAMINATION (Resumed)

QUESTIONS BY MR. GEORGE:

Q. By the way, Mr. Gerhart, are you—were you aware, when you were dealing with Neodata, the companies it did business with besides your company, in terms of magazines, or some of them?

A. Some of them, certainly.

Q. Can you name them?

A. Well, *Bon Appetit, Architectural Digest.* Frankly, Mr. George, there are so many of them I'd run a real danger of being wrong.

Q. What about the fulfillment house in Iowa? What's the name of that one, by the way, that you're using now?

A. It's CDS, which I believe stands for Communications Data Specialist.

Q. Okay, and do they fulfill the subscriptions of other magazines like they do yours?

A. A number of them, yes.

(p. 181) Q. During the course of your work at Texas Monthly, have you had an opportunity to investigate other companies that provide national fulfillment services for magazines?

A. Not in depth in the sense that we did CDS but have been investigating them enough to be familiar with who their clients were and what their cost structures were.

Q. Okay, and in the course of that work, have you learned that most, if not all, national magazines are circulated through fulfillment houses just like you are?

A. That's correct, we have.

Q. And is that the case?

A. It is the case.

Q. By the way, where is *Playboy* circulated through? Is it through Neodata or CDS?

A. Well, it was at Neodata and I don't know—I think it's there because one time they sent our billing series to all of the latest *Playboy* people.

Q. I remember that.

A. Yes, I thought you might.

Q. I thought you might know about that (p. 182) one. Now, in connection with the—your work, have you made an effort to try to have purchases made of magazines that are religious in nature—

A. I did.

Q. —that are published in Texas?

A. Yes, sir.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 34 and 35 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what is Exhibits Nos. 34 and 35 and ask you if you can identify them?

A. These are two publications that my staff, at my direction, purchased, one by subscription and I believe the other one just—actually I think she subscribed to both of them.

Q. Were there sales taxes charged on any of those subscriptions?

A. Neither.

Q. And they're both published in Texas?

A. That's correct.

MR. GEORGE: I'll offer Exhibits Nos. 34, *Grassroots*, a publication of the Episcopal Churches of Texas,

and a book called *Journal of Church* and *State* published by (p. 183) Baylor University, I believe, the J. M. Dawson Institute of Church and State Studies at Baylor University.

MR. MENDEZ: Well, we've never seen those publications before, but I guess we have no objection. I think they fit the hearsay rule anyway.

THE COURT: No objection?

MR. MENDEZ: No objection, Your Honor.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, let me ask you, Mr. Gerhart, in connection with the collection of sales tax, what—can you explain to the Court what problems that presents for Texas Monthly when you ask someone to pay the sales tax and they don't pay it for a subscription—or subscriber?

A. Well, if we ask them to pay it and they don't, the problem is that we simply have to pay it for them.

Q. Why don't you just withhold the magazine and not send it to them unless they send you the six percent sales tax?

A. Well, this goes back to the model (p. 184) that we subscribed earlier. Our obligation to run the magazine and to fulfill the guarantees that we have sold to advertisers some months before for any given issue is to acquire and have paid subscribers for each issue so that we can be sure that we send 280,000 copies, and the issue of whether someone has paid or not paid the sales tax doesn't affect

the paidness of the copy. So that subsequently if we have a person who chooses to send in their money but chooses to not pay the sales tax, one, it's not economically efficient to bill them for the 62 cents. It costs us 6 or $8 by the time we generate the bill, stuff it in an envelope and pay the postage and so forth. So we don't do that, but we certainly don't not (sic) send them their copy. Otherwise we would not have any certainty, in terms or our ability to meet our guarantee on our advertising. That's a different issue, Mr. George, than the one of why don't we ask them to pay it to begin with, but that's just—I just point that out. This is—

Q. Well, I was going to ask you if you've asked them to do that, and we have Mr. Childs' circulation—

(p. 185) A. Right. Okay.

Q. That's the test, and we'll put on that for—

A. Okay.

Q. But I'm dealing with the general problem of nonresponsiveness of subscription consumers to the demand to pay the tax and what—why that won't work from economics and that sort. Let me ask you what percentage of your magazine subscriptions are sold on credit instead of they send the money in in advance?

A. I would guess 50 percent. It may be less than that. I know that our major direct mail offer solicits cash with their order, and there is a very high response as a result of that, and it made—Mr. Childs would know that figure more closely, but it may be as low as 30 percent as for credit payments.

MR. GEORGE: Okay. I'll pass the witness.

THE COURT: We'll take a recess at this time. We'll recess for 15 minutes.

(At this time a brief recess was taken, during which time an (p. 186) instrument was marked as Defendants' Exhibit No. 1 for identification, after which time the proceedings continued as follows:)

CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. I have a few questions on cross examination. Mr. Gerhart, I've had an exhibit marked in the interim here as Defendants' Exhibit No. 1. Could you identify this document for us, please?

A. This is an ABC Publisher's Statement for the period—six-month period ending December 31st, 1984 for Texas Monthly.

Q. Okay, sir, and is that the pink sheet that you were referring to earlier during testimony?

A. It is.

Q. Okay, and you have these types of sheets for other magazines that are in circulation in Texas?

A. Yes, sir.

Q. Okay, and it was your testimony that these could be used or made available to the Comptroller's office, if they so desired; is (p. 187) that correct?

A. It is.

Q. Okay. Could you point to the Court where on that document the Comptroller might determine or one of his

employees might determine what locations a—one of these magazines that has a pink sheet has in the State of Texas?

A. I will. Your Honor, the report is—shows average circulation and sources of acquisition for a six-month period, but the publisher picks one issue during that six-month period, and he reports the distribution by state for both single copy or subscription sales and newsstand sales. So that one can look at a state—for instance, in this case for that issue of ours we had 211,436 copies of subscriptions came here out of the total of 242,000 subscriptions, and we had virtually all our newsstand. So that you could look at this same kind of distribution on any ABC statement and get for that one issue what the distribution was in the state, and one would have to make some assumptions about the stability of the circulation of the magazine and project that to (p. 188) the total distribution.

Q. Well, let me ask you a few questions about that. Isn't it true that all of that back page of that pink sheet has is how many magazines were circulated into a particular state? Is that what it says on there?

A. For that given issue, yes, sir.

Q. Okay. Does it—and what I'm asking you is does it say anywhere on that pink sheet that that particular magazine has a location in the State of Texas or some other distribution point in the State of Texas, and that's what I'm asking you?

A. This one does, yes.

Q. Okay, because that's *Texas Monthly*'s?

A. That's correct.

Q. Okay, but what I'm asking you is does every one of those pink sheets—let's say, one from some hypothetical out of state—

THE COURT: Well, use the *Reader's Digest.*

QUESTIONS BY MR. MENDEZ:

Q. —*Reader's Digest*—would *Reader's Digest's* pink sheet indicate that it had a location in the State of Texas on that document?

(p. 189) A. Not necessarily.

Q. Okay, and is there a standardized place on that document where it would show its warehouse or its office or its advertising office in the State of Texas?

A. No, there's not.

Q. Okay, sir. Now, you have mentioned that *Texas Monthly* is located in Austin. Does *Texas Monthly* have any facilities or locations in other cities in the State of Texas?

A. It does.

Q. Okay. Could you tell the Court where those locations are?

A. We have an advertising editorial office in Dallas, Texas and in Houston, Texas.

Q. Does *Texas Monthly* have any other locations in Texas at all?

A. No, it does not.

Q. Okay. Does *Texas Monthly* have any salesmen that might travel to other locations in Texas?

A. Yes, we do.

Q. Specific cities?

A. We have a sales force in Austin, Dallas and Houston, and salespersons from any of (p. 190) those three could on any occasion travel anywhere in the state.

Q. Okay, sir, and now, I want to ask you a question about is it *Texas Monthly's* business decision—or is it your testimony that it's *Texas Monthly's* business decision to operate through a fulfillment house?

A. Yes, it is.

Q. Okay. In theory at least, couldn't you set up a subscription department here in your own headquarters and sell your subscriptions through that? I mean, in theory is what I'm asking.

A. You mean realistic theory? No, we couldn't.

Q. Okay. You could not sell your subscriptions in any other way?

A. Well, for the computer systems it would take to run an adequate size to do what we would have to have done given our size, it simply wouldn't be feasible for us to own ourselves.

Q. Okay, sir, so what you're saying is that it's your business decision to operate through a fulfillment house because it makes it (p. 191) cost effective for you to sell your magazine on a volume basis?

A. That's correct.

Q. Okay, sir. Now, is it *Texas Monthly's* business decision to sell by subscription at all?

A. Yes.

Q. Okay, and you could sell the magazine just over the counter, if you wanted to; is that correct?

A. You mean only over the counter?

Q. Only over the counter.

A. We could sell some copies over the counter, yes.

Q. Okay, but you made a conscious—*Texas Monthly* made a conscious decision on a business like basis to try to address a larger market, and that was through a subscription approach; is that correct?

A. Yes, it is correct.

Q. Now, I want to understand how you decided to apply the tax rate at six and an eighth to your total volume of taxable sales. Is that a decision that you made or that someone in the management of *Texas Monthly* made?

(p. 192) A. Yes, it is.

Q. Okay, and is it Texas Monthly's business decision to send out issues of its magazine without—to subscribers without insisting that they remit the use tax first?

A. Yes.

Q. What I'm asking you is did you make a conscious decision to enter into subscription contracts with persons and then start honoring those contracts without asking them, "Send me the Texas use tax first"?

A. Yes.

Q. Okay, sir. Now, I'm going to hand you the tax code, and it's Article—I mean, Section 151.103, and I'm going to have you read 151.103—the first section of that to the Court.

A. "151.103. Collection by retailer, purchaser's receipt. A retailer engaged in business in the state who makes a sale of a taxable item for storage, use or consumption in this state shall collect the use tax that is due from the publisher and give the purchaser a receipt for the tax payment."

Q. Okay, sir, and I'm going to ask you (p. 193) now did Texas Monthly collect a tax from the users and give them a receipt for that tax?

A. No.

Q. Okay, and why didn't it do it?

A. Well, we didn't give them a receipt because we didn't collect the tax.

Q. Okay, and why didn't—doesn't that statute say shall collect a tax in there?

A. Yes, it does.

Q. Okay, and I'm asking you that's a Legislative enactment, and I'm asking you—well, do you-all have a sales tax and use tax permit?

A. We do.

Q. Okay, and you're a retailer, do you understand, under that statute?

A. I guess so.

Q. Okay, and I'm asking you did you make a conscious decision not to collect a tax, as it says to do it in that statute?

A. We did.

Q. Okay, and what was the basis for making that decision?

A. Because the cost to us—economic cost to us, if we attempted to collect the sales (p. 194) tax and whether we gave a receipt or not, was so high that our decision was—so we could stay in business—that we wouldn't attempt to do that.

Q. Okay. That's a business like decision, don't you think? I mean, isn't that the reason you did that?

A. That's correct.

Q. Okay. You don't have a moral obligation not to collect use taxes or some other conscience that says, "well, I'm not going to impose a use tax on these people." You just did it because it was a business decision; is that correct?

A. Well, we have an obligation to pay the tax to the State—

Q. But you figured—

A. —and we do that.

Q. Okay, and your testimony is that you figured that by backing into it through your gross sales and the amounts of copies delivered to Texas citizens; is that correct?

A. That's correct.

Q. Okay, but you didn't follow the letter of that statute, did you?

(p. 195) A. We did not.

Q. And you couldn't follow the letter of that statute in carrying out your statutory duties and stay in business; is that correct?

A. That's correct.

MR. MENDEZ: We'll pass the witness.

REDIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Mr. Gerhart, you mentioned a sales force in some of these cities. Do these people sell subscriptions or sell advertising?

A. They sell advertising.

Q. Okay, and in terms of making advertising sales, that's to solicit Neiman-Marcus or other people to run ads in your magazine; is that right?

A. That's correct.

Q. Now, in connection with subscription sales force, you don't have your own employees that are—that sell consumers the magazine, do they—do you?

A. We—not directly on a personal basis. We have staff in the office who (p. 196) coordinate the construction and use of the other techniques I have described earlier.

Q. You have a circulation director that's—

A. And a department that works under him that does try and procure subscribers.

Q. Do you have door to door salesmen or other sales force that sell the readers like me or Mr. Mendez subscription sales?

A. No, we do not.

Q. And in connection with your subscription sales efforts in Texas, they're carried on not by sales force located in three cities but in the manner we talked about before?

A. That's correct.

MR. MENDEZ: Before—I don't have any more questions, but before he steps down, I'd like to offer Defendants' Exhibit No. 1 into evidence.

MR. GEORGE: No objection.

THE COURT: Admitted.

MR. MENDEZ: Thank you.

MR. GEORGE: Pass the witness.

MR. MENDEZ: No further (p. 197) questions.

MR. GEORGE: We'll call Steve Childs.

STEPHEN A. CHILDS

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. My name is Stephen A. Childs, and my address is 1706 West 30th Street.

Q. Austin, Texas?

A. Austin, Texas.

Q. Okay. How are you employed?

A. I am the circulation director at *Texas Monthly.*

Q. Okay, and what are your duties as circulation director at *Texas Monthly?*

A. My duties are to maintain our rate base and to—

Q. What's a rate base?

A. A rate base is the guaranteed (p. 198) circulation that we give to advertisers—that we promise to advertisers, and it is the circulation on which our advertising rates are based.

Q. Okay, and how many copies of the magazine are in your rate base now today?

A. 280,000.

Q. Okay, and does the rate base change from time to time?

A. It can.

Q. Okay. Now, is there a need for the magazine—for *Texas Monthly* magazine to solicit new subscribers?

A. Yes.

Q. And can you tell the Court how you go about soliciting such subscribers?

A. Well, we have a variety of channels of sale. We solicit subscribers primarily through direct mail. We also use agencies—subscription agencies.

Q. Let me stop you and ask you to tell the Court—explain to the Court how the direct mail solicitations work.

A. All right. It may be easier if I used the board over there. May I do that?

(p. 199) THE COURT: Sure.

THE WITNESS: A direct mail campaign is done by first renting a group of lists. These lists may be magazine lists or compiled lists. They're primarily magazine lists that share similar demographics.

QUESTIONS BY MR. GEORGE:

Q. Lists of what?

A. Lists of names and addresses of other subscribers, if they're magazine lists, but they're lists of names that share similar demographics to our magazine.

Q. And what do your magazine—what are your magazine demographics? By that, do you mean the characteristics of your subscribers?

A. Yes, it's the—

THE COURT: Education level?

THE WITNESS: Education level, the income level, the median age and so on.

QUESTIONS BY MR. GEORGE:

Q. And by the way, what do you think are the demographics of *Texas Monthly* subscribers?

(p. 200) A. Well, the median age is approximately 40. The income level is in the 40,000 range. The education level is overwhelmingly college-educated, postgraduate work, married, 50 percent male, 50 percent female. Those are the primary characteristics.

Q. Do they live predominantly in Texas?

A. Yes, 90 percent of them live in Texas.

THE COURT: Or former Texans?

THE WITNESS: Right.

QUESTIONS BY MR. GEORGE:

Q. Okay, and I'm sorry. I interrupted you. What you do—you rent the lists from people that have lists of names?

A. Yes, we first get the lists. The second thing we do is we use a computer service to perform what we call a merged purge.

Q. Are those—that computer and your people at the fulfillment house in Iowa that does that for you?

A. Yes, in our case our fulfillment house is also doing our—

THE COURT: What's a (p. 201) merged purge?

THE WITNESS: The merged purge is where we take all of these lists, and they feed them into a computer system, and they literally merge the names together so that they can identify, first of all, who are already sub-

scribers to our magazine. They kick those out. Secondly, they purge out all of the duplicates. The name may appear on more than one list. So we keep it once and then purge out all of the duplicate names.

After doing this we arrive at our net names, and from these names they generate labels, which are then applied to our direct mail pieces.

So the third element of a direct mail campaign is the package, and on the package, these labels will be applied, and we tend to use the same package. Once we know it works, we use this package over and over. It's called our control package, and from time to time we will do tests against this package. A test is primarily a version or a different package that we test against this package using the same body of names, and we randomly select (p. 202) across this list so that we get statistically valid groupings of names for the tests, as well as for the control package. The names—the characteristics of the names are indistinguishable between each other.

QUESTIONS BY MR. GEORGE:

Q. Now, you run these tests, I take it, to see whether a price of $12 for 14 issues is better than $10 for 12 issues and that you get more buyers at different kinds of prices, as a hypothetical example?

A. Yes.

Q. Or you might add other characteristics to your offer or six-month subscriptions versus two years or some other characteristics?

A. That's right. The overall purpose of these tests is to find some element that will ultimately increase our response rates.

Q. Okay, and do you use these tests on a regular basis?

A. Yes, we do.

Q. Once a year or more frequently than that?

A. Usually we're testing something in (p. 203) every direct mail campaign, and we mail about four times a year.

Q. Okay. All right. Now, you were telling the Court what you did to maintain your rate base or to build up circulation. Why don't you tell the Court what you—you can sit back down, if you want to.

A. I'm sorry. Could you repeat the question?

Q. You were telling the Court the other things you do besides the direct mail campaigns to maintain your rate base or the number of subscribers and users of *Texas Monthly*. What else besides direct mail?

A. Besides direct mail we have insert cards, which are bound into copies of the magazine. There may be one in that copy right there, and those go into both our newsstand and subscriber copies.

A third method of obtaining subscriptions is through subscription agencies. Those are primarily, in our case, direct mail agencies and school agents, direct mail agents being an agency that sends out—Publishers Clearinghouse is an example. They (p. 204) send out stamp sheets and people choose the number of magazines they want. They

send it back to the direct mail agent. The direct mail agent then forwards those orders to the individual publishers, and they take the majority of the subscription price as their commission. School agents enter into arrangements with schools so that the schools have school children that go around to the neighborhoods and basically take orders for a variety of magazines on an individual publisher's behalf.

Q. Now, let me ask you for those school agents, at least, those are—are those in Texas or other places?

A. They're all over the country, but for us we use them in Texas.

Q. Obviously you need subscribers in Texas?

A. In Texas, right.

Q. Okay, and so the school agents you hire deliver your—solicit orders for you in Texas?

A. That's correct.

Q. Okay, and are there any other (p. 205) methods besides direct mail, insert cards and the agents that you use that you maintain your—

A. Those are the primary three.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 36 through 39 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I hand you what has been marked Plaintiff's Exhibits Nos. 36 and 37. Can you identify those for the Court, please?

A. Yes, I can. This is the school plan booklet for *TV Guide,* TV Guide School Plan.

Q. Now, tell the Court is that one of these people who have children or others go around and solicit subscriptions for you?

A. Yes, it is. We are in this particular booklet, and this booklet identifies all of the magazines that this particular school plan offers through their schools that they enter into arrangements with.

Q. And those are used in Texas; is that correct?

A. Yes, that's correct.

Q. To solicit subscribers for you among others?

(p. 206) A. Yes.

MR. GEORGE: I'll offer Exhibit No. 36.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Would you tell the Court some of the magazines that solicit subscriptions through *TV Guide's* plan that are in that book?

A. Well, virtually every magazine in the country is in here but *American Film, The American West, Dallas Magazine, Denver Magazine, Ellery Queen's Mystery Magazine.* I'm sure if I go over here, we'll find some of the better known names. There's *Popular Bridge,* and then we have *Texas Monthly, Texas Fisherman, Texas Business.*

Q. How about *Reader's Digest?*

A. *Reader's Digest* is probably in here. Let me just find it. No, *Reader's Digest* is not listed in this particular one.

Q. Okay. Is *Playboy* listed?

A. *Playboy?* There are three different sections of this booklet. That's why I'm checking the alphabetical listing under each. I (p. 207) don't see *Playboy* in this particular one, but I have seen it in the past.

Q. What is Exhibit No. 37?

A. Exhibit No. 37 is the authorization agreement that I enter into with *TV Guide's* school plan.

Q. I notice that the company is Mediatex Communications Corporation. Can you identify for the Court who that is?

A. Mediatex Communications Corporation is the parent company that owns Texas Monthly, Inc.

MR. GEORGE: I'll offer Exhibit 37.

MR. MENDEZ: Before I object to it or not object to it, is that authorization strictly for *Texas Monthly* magazine subscription sales?

THE WITNESS: Yes, it is.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. I'll show you what's been marked as Exhibit No. 38, which is an envelope and 38A and B and 39 and ask you if you can identify those?

(p. 208) A. Exhibit No. 38A is the booklet that *Reader's Digest* company uses. I believe this is their QSP subsidiary. That's Quality School Plan, and in this particular booklet they're offering *Money* magazine, *Golf* magazine, *Golf Digest, Discover, Sports Illustrated, Los Angeles* magazine, *Texas Monthly, Time Magazine,* and virtually any that you could name.

Q. How about *Reader's Digest* in that one? Let's try *Reader's Digest* in that one.

A. Let's see. Yes, there is *Reader's Digest* at one price, *Reader's Digest-French Edition, Reader's Digest-Spanish Edition.* That about covers *Reader's Digest.*

Q. Okay, and those again—is that a company you have a contract with?

A. This particular company, yes.

Q. And is the Exhibit 39 a copy of that contract?

A. Yes, this is our authorization agreement.

Q. Okay, and those—is the catalog that is Exhibit 38 the catalog used to sell your magazine along with the other magazines by school agents in Texas?

(p. 209) A. Yes, it is.

Q. Okay, and to solicit subscriptions for you along with subscriptions for *Reader's Digest* and *Golf* and *Skiing* and all of those other magazines?

A. That's correct.

Q. Okay. What about the rest of Exhibit 38?

A. This appears to be the order form that the school children use when they go up to someone's house and ask

them what magazines they want to subscribe to, and they fill out all of the names and addresses on here. These are then sent back to the school agent who then processes them and sends the orders to the publishers.

Q. Okay, and that's part of the package used for your magazine solicitations through that company?

A. Yes, it is.

MR. GEORGE: Okay. I'll offer Exhibit 39, and did you identify them?

QUESTIONS BY MR. GEORGE:

Q. Exhibit 39 is the contract?

A. That's right.

MR. GEORGE: I offer (p. 210) Exhibit 39.

MR. MENDEZ: No objection to 39.

THE COURT: Admitted.

MR. GEORGE: And 38A and 38B along with 38, which is the cover of those two exhibits.

MR. MENDEZ: I'll object to those, unless I can take him on voir dire. I want to understand how he knows what these things are used for.

THE COURT: All right.

VOIR DIRE EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Childs, you indicated, in looking at the form that's included in that, that that is used as an order form. Have you ever seen these before today?

A. Yes, I have.

Q. Okay. Where have you seen them?

A. I have seen them in my office. These are sent to me regularly from the various school agents, and they keep us up to date on exactly what materials they're using in their (p. 211) solicitations. Seeing as how they're making money off of us, they want us to be apprised of what their activities are.

Q. Okay. So your testimony is that you're familiar with those types of order forms such as Exhibit 38B and that that's the form that is used to take the order for your magazine; is that correct?

A. Yes.

MR. MENDEZ: Okay. I withdraw my objection.

THE COURT: Admitted.

DIRECT EXAMINATION (Resumed)

QUESTIONS BY MR. GEORGE:

Q. Now, Mr. Childs, can you tell the Court whether or not your company has conducted any of the tests that you've described for the Court to determine the affect of a sales tax on your effort to maintain your rate base or in getting subscribers to *Texas Monthly??*

A. Yes, we have.

Q. Okay. Would you explain to the Court what you did?

A. We conducted a test, as I described (p. 212) it over there on the board, where we tested two panels of

5,000 names each. One of the panels had on the order card, which was the control panel—had no mention of sales tax. It simply had our control offer, which is 12 issues for $12 or 14 issues for $12 with payment, and then on the test panel—on the test order card we had an asterisk after the price. We said 12 issues for $12.62 asterisk, and that was a footnote at the bottom of the order card saying plus 62—or include 62 cents sales tax, I believe is what it says. The net result of this test was that 17.3 percent fewer subscribers responded to the panel that mentioned sales tax versus the panel that did not.

Q. What's the affect on *Texas Monthly* of a—such a reduction in a response? Is that a big reduction or a small reduction?

A. It would be disastrous. It would significantly reduce our ability to acquire subscriptions, thereby reducing our circulation, thereby reducing our rate base, which would hurt our advertising rates, and the economic effect would be far beyond a simple subscription—the simple subscription price of $12.

(p. 213) (At this time instruments were marked as Plaintiff's Exhibits Nos. 40 through 42 for identification.)

QUESTIONS BY MR. GEORGE:

Q. Mr. Childs, while Mr. Mendez examines those exhibits, let me ask you in conducting this test was there any difference between the list of names of people who were mailed the package containing the reference to sales tax and the people who weren't?

A. No, there was no difference whatsoever. Because of the method that we select the names, it renders

both panels indistinguishable in characteristics. The names and addresses on each panel are demographically and characteristically identical. They're not the same names and addresses on each panel, but the way they're selected statistically they're identical.

Q. Was the tests that you ran to test the effect of the sales tax on your publication and the attempt to collect it run in the same manner you run the tests that you run as a routine part of your business every—four times a year when you send out mailings?

(p. 214) A. Yes, it was.

Q. I'll hand you what have been marked Exhibits Nos. 40, 41 and 42 and ask you if you can identify those, please?

A. Exhibit No. 40 is the order card that shows the sales tax. Do you want me to read these or—

Q. No, not necessarily.

A. —just identify them? Exhibit No. 41 is our control order card. This is the order card we use all of the time.

Q. Is there any difference between 40 and 41, except the reference to the tax?

A. No, there is a line on one that is insignificant, as far as response.

Q. Okay, and what is Exhibit No. 42?

A. Exhibit No. 42 is a summary of the results between these two panels, which ultimately shows that the test panel had a 17.3 percent reduction in response over the control.

MR. GEORGE: I offer Exhibits 40, 41 and 42.

MR. MENDEZ: No objection.

THE COURT: Admitted.

MR. GEORGE: Pass the (p. 215) witness.

CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Childs, you mentioned that you—

MR. MENDEZ: If Your Honor might—if you could hand him those so that I could ask him a few questions?

THE COURT: Which ones do you want?

MR. MENDEZ: These tests and these panels here.

QUESTIONS BY MR. MENDEZ:

Q. Mr. Childs, when did you conduct this study again? When did you mail them out?

A. These were mailed on December 27th of 1984.

Q. And were they mailed by your fulfillment house?

A. No, these were mailed by a letter shop that we hire to do our direct mail campaigns in Dallas.

Q. So they were mailed from Dallas?

A. Yes, that's correct.

Q. Were they mailed to persons (p. 216) throughout the State of Texas?

A. Yes, they were—only to people in Texas.

Q. But they weren't limited to a specific geographic area, were they?

A. Not within Texas.

Q. Okay, sir. You mentioned that there was a 17.3 percent decrease in response between the persons that answered the test panel and those that answered the control panel; is that correct?

A. Yes, that's correct.

Q. Okay. Is that a gross response rate or a net response rate?

A. That is a net response.

Q. Okay. Could you explain for the Court what a gross response would be, as opposed to the net rate?

A. Gross response denotes the number of people that send in the card, some being cash orders and some being bill me later orders or credit orders, as we call them. Net response is the number of cash orders plus the number of paid credit orders.

Q. Okay, sir.

(p. 217) A. Or in other words, the total number of paid orders that came back.

Q. There seem to be two differences on your test panel from your control panel. Could you refer to those exhibits, please, and I'll ask you, if you don't agree with me, there's a difference in price, of course, of 62 cents; is that correct?

A. That's correct. The 62 cents was the, at the time, five and an eighth percent sales tax added on to the $12.

Q. And of course, there's the notation there of the asterisks and then the notation of tax included at the bottom. Is that another difference?

A. Yes, the asterisk I referred to, yes.

Q. Okay. You were present at some depositions that were held during the course at discovery in this case where another test might have been had where the only difference was an asterisk that then referred you to a footnote that said "plus tax." Do you remember that?

A. Yes, I do.

Q. Okay, and there was a difference of—in response rates in that case, wasn't there?

(p. 218) A. Yes, the one that had the asterisk plus tax had a lower response rate than the one that did not.

Q. And if you'll remember, the price was exactly the same on both cards. It's just that it had an asterisk. The control panel and the test panel both had the same price. It's just one had an asterisk with the two words "plus tax"?

A. I believe that's correct.

Q. Is there any way for you to tell whether in your test panel, which you've got right in front of you—that test that you ran—whether if you had just raised the price by 62 cents and not included that asterisk, would that have affected the response rate?

A. It may have.

Q. Okay, and of course, I think it's been your testimony through—at least in depositions, that the group that you're after is a rather finicky group. The magazine

readers are a finicky group and that anything that you change in your control panel price or term or language has a tendency to affect their response rates. Isn't that a fair statement of what you (p. 219) said before?

A. I don't know if I would term them finicky, but I would say that people that respond to mail order—direct mail are primarily impulse purchasers. I mean, they want to make a quick decision, and anything that gets in their way of making that decision can significantly hinder response.

Q. And it's pretty hard—your job is relatively hard because you've got to try and read these people and get them to buy your publication, but you never know exactly what a particular language or term change is going to do to their response; is that correct?

A. Well, over time we develop theories about it, but that is why we do tests continuously.

Q. What I'm asking you is it's a difficult job to determine; right?

A. It's difficult, if you don't test. If you test each variable, you can always read the response scientifically.

Q. Okay, sir. Well, what's it—what would be the difference, if you hadn't included the asterisks and the words "price includes 62 (p. 220) cents sales tax"?

A. I don't know because I haven't—I didn't test it, except for this way.

Q. Okay, but from your experience in doing these tests, would it be possible for you to say, "Well, it would

be worth .3 percent or 1.3 percent" or some specific number?

A. I wouldn't hazard a guess because as you pointed out they are—it is difficult to read, unless you actually go through the tests.

Q. Okay, sir. Well, I want to—based on that I want to get into something else. You mentioned two things that, in your opinion as the circulation manager, are going to affect—are going to happen to *Texas Monthly*. One of them is that this represents a significant change. If you do this, it's going to represent a significant change in the readership population. Can you tell us exactly how many dollars less *Texas Monthly* is going to make from subscriptions, if it adds this language into its form—its basic subscription form?

A. I couldn't tell you that off the top of my head, but I believe that number has been calculated somewhere. Our expert witness or (p. 221) someone has that figure.

Q. Would you know if you changed the asterisks and you just raised the price by 62 cents what effect that would have?

A. I would think that a price increase would lower the response. From the readers' point of view, this sales tax is making it more complicated for them to subscribe, and magazine readers are price sensitive.

Q. Can you tell the Court exactly—

MR. GEORGE: I would like to let the witness finish the answer.

THE COURT: Let the witness finish.

THE WITNESS: Magazine readers are price sensitive, and by adding the 62 cents tax, it's going to have an affect (sic) to lower the response.

QUESTIONS BY MR. MENDEZ:

Q. Can you tell the Court exactly how many dollars that would mean in terms of subscription revenues?

A. No, as I said before, I don't have that figure off the top of my head.

Q. Okay, sir. Now, you mentioned that (p. 222) it would cause a disastrous result for the corporation, and of course, we're involved here in lawsuit where *Texas Monthly* must show injury. Do you think that this—the adding of these words requiring the collection of the tax would drive *Texas Monthly* into bankruptcy, let's say, or to seek the protection of the Court, in terms of its financial condition?

A. It could over time. I'm not going to guess at whether or not it would bankrupt the company, but I do know that it would put it in severe jeopardy, in terms of where it is today.

Q. Well, how long would it take for this to affect the operations of the company so that it could no longer operate effectively?

A. I haven't tried to make those calculations myself, but I believe Mr. Lepere has calculated some of those numbers.

Q. So when you say that this is going to have disastrous or severe consequences, that's just your idea as to what it's going to do to your subscriptions; is that correct?

A. Well, it's really looking at the notion of a 17.3 percent reduction in our circulation, which roughly translates into (p. 223) 40,000 subscribers. If you take those 40,000 subscribers away from our circulation, you end up with a significantly lowered rate base. If you end up with a significantly lowered rate base, you can charge significantly less money in advertising. So it has a compounding affect.

Q. But what I'm asking you is can you tell the Court exactly how much or when these things are going to happen?

A. How much?

Q. How much of an impact in dollars is this going to have on the corporation, let's say, by next accounting year-end?

A. As I said before, I believe Rick Lepere has calculated numbers to that effect.

Q. Okay. Now, has *Texas Monthly* continued to use these test panels subsequent to its tests which started in December of 1984?

A. Have we continued to use our control panel?

Q. Your test panel.

A. The one that adds the tax?

Q. Yes, sir.

A. No, I made the decision based on the results of this test not to continue to attempt (p. 224) collecting tax.

Q. You made the decision not to include a reference to taxes in your solicitation form by direct mail; is that correct?

A. Yes.

Q. Okay, and did you make any decision as to how to deal with that on insert cards?

A. We've decided not to mention the tax on any of our promotion pieces.

Q. And did you decide to do anything about sales or use tax collection in regard to your agent solicitations in the State of Texas?

A. No. We didn't decide to do anything. I mean, we enter into arrangements with them to sell subscriptions at whatever rate we give them. Let's say it's 12 issues for 11.97. How they deal with the tax issue I'm not aware.

Q. Okay, sir, and to the best of your knowledge, there's no reference to tax in the solicitation offer that they give the Texas residents?

A. I have not seen any.

Q. Okay, sir, and so isn't it —

A. Any reference, that is.

Q. Okay, sir. So then wouldn't it be (p. 225) fair to say that there's been no impact on *Texas Monthly's* rate base because, aside from this small test of 5,000 persons,

you haven't used this type of language anywhere else in your solicitation efforts?

A. Currently the mention of tax has not affected our rate base because we're not doing it for the express purpose that it would damage our rate base.

Q. Okay, sir. So there's no evidence at this point then, or you don't know of any actual loss that might have occurred up to this point on the rate base because of the affect of the tax on *Texas Monthly;* is that correct?

A. Well, I would consider this test as evidence that there is significant damage or could be significant damage if we were to implement this procedure or the procedure of mentioning tax on any of our promotion pieces.

Q. And what if you kept doing it the way you're doing it now?

A. If we kept doing it the way we did it now?

Q. Yes, sir.

A. Which is not mentioning tax?

(p. 226) Q. Exactly.

A. We would not be able to collect the tax.

Q. Okay. So is it then a business decision on the part of *Texas Monthly* not to include any language with respect to the sales or use tax in any of its solicitation materials?

A. At this time, that's correct.

Q. Okay, and it's a business decision, to the best of your knowledge, to calculate the tax in the manner that

Mr.—well, by backing into it by determining the number of magazines that you sold in Texas and the revenues derived therefrom?

A. Whatever method Mr. Gerhart explained is the method that we're using.

MR. MENDEZ: Thank you, sir. Pass the witness.

REDIRECT EXAMINATION

QUESTIONS BY MR. GEORGE

Q. Mr. Childs, as I understand it, you're simply paying your gross receipts tax; is that right?

A. Effectively, yes.

(p. 227) Q. And you've determined that—on the basis of your test and your experience, that there's no way to collect the tax from the people who owe the tax, that is, the users?

A. That's correct.

MR. GEORGE: That's all of the questions I have.

RECROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Well, Mr. Childs, what is a gross receipts tax?

A. What is a gross receipts tax?

Q. Yes, sir.

A. I believe that it's a tax off the revenues collected.

Q. Are you a lawyer, sir?

A. No, I'm not a lawyer.

Q. Okay. Have you ever seen any gross receipts taxes that are imposed by the State of Texas?

A. Have I seen any?

Q. Have you—do you know of any gross receipts taxes that are imposed by the State of Texas?

(p. 228) A. No, I do not.

Q. Do you know where the incidence of that tax might fall?

A. No, I do not.

MR. MENDEZ: Pass the witness.

MR. GEORGE: That's all of the questions we have.

THE COURT: You may step down.

THE WITNESS: Thank you.

CORINA TIEMEYER

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. Corina Tiemeyer, 11711 Memorial Drive, No. 47, Houston 77024.

Q. And how are you employed?

A. I'm the associate publisher and general manager of *Houston City* magazine.

(p. 229) Q. Could you describe *Houston City* magazine for the Court, please?

A. It's a general interest magazine concerned with life in Houston.

Q. It is circulated to consumers, as opposed to business readers basically?

A. Yes.

Q. Is it a magazine appealing to the same kind of reader *Texas Monthly* appeals to only for Houston, as opposed to the whole state?

A. Yes.

Q. Can you tell the Court where it is printed?

A. It is printed in West Virginia.

Q. Do you circulate the magazine through the mail subscriptions?

A. Yes.

Q. Okay. Do you circulate over the newsstand, as well?

Q. Approximately what percentage of your total circulation is through the mail, and what percentage is on the newsstand?

A. 75 percent is through the mail. 25 percent is on the newsstand.

(p. 230) Q. All right, and in connection with those copies that you mail, are most of them to people in and around Houston?

A. Yes.

Q. How do you go about getting it printed and to the people in Houston? Is it printed in—where is it printed? I'll ask it that way.

A. You mean how does it get from the printer to Houston?

Q. Yes.

A. It gets trucked from the printer to the Houston post office, and then the post office mails it, and it goes to the subscribers in their home.

Q. Okay, and does the printer truck it from West Virginia to the post office in Houston?

A. Yes, he arranges for that.

Q. Do you—how do you go about fulfilling the subscriptions? Do you have a company that is in charge of maintaining your subscriptions and that sort of thing?

A. Yes, Fulfillment Associates, Incorporated.

THE COURT: Who?

(p. 231) THE WITNESS: Fulfillment Associates, Incorporated.

QUESTIONS BY MR. GEORGE:

Q. And where are they?

A. In New York.

Q. What was your employment before you went to work for *Houston City* magazine?

A. I was a vice-president of Bayland Publishing, which had two magazines—*Houston Home & Garden* and *Dallas/Fort Worth Home & Garden.*

Q. And what was your business before that?

A. I was in direct mail advertising for about 15 years.

Q. In your jobs with *Houston City* and with your prior employer, have you had occasions to deal with other fulfillment houses?

A. Yes, Neodata.

Q. Any others?

A. No.

Q. And where was Neodata?

A. In Boulder, Colorado.

Q. Have you done any—made any efforts to try to determine what affect (sic), if any, (p. 232) attempts to collect the sales tax would have on *Houston City* magazine and under its operation?

A. I did a direct mail test, which noted a sales tax a year ago.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 43 through 45 for identification.)

QUESTIONS BY MR. GEORGE:

Q. Ms. Tiemeyer, can you describe for the Court how your company goes about making—sending direct mail solicitations to potential subscribers?

A. We rent the use of other people's mailing lists—other publications' mail-order companies. We merge purge the names. That means merge the names together and purge out the duplicate names. We select the lists by demographics, trying to find people that fit the profile of our readers, and then we mail packages to those people.

Q. About how frequently do you do that?

A. Twice a year.

Q. Okay, and do you regularly run tests to determine the effect of particular changes on your offer or the way your test package looks or (p. 233) other things?

A. Yes, always.

Q. And that's a regular part of your business?

A. Yes.

Q. And you said you ran a test in response to the effect of the sales tax in the fall of '84; is that correct?

A. December of 1984.

Q. Okay, and was that test run the same way the tests were run for your regular course of business?

A. Yes, it was.

Q. Okay. Can you describe how the test was run?

A. We Nth name selected a control panel.

Q. You're going to have to stop and explain what Nth name means.

A. Randomly selected names from our mailing lists the size of 400,000. We selected 10,000 randomly for the tax tests and 10,000 randomly for the control panel, control panel being the exact same mailing piece as the major portion of the mailing. We selected 10,000 and 10,000 because that would be an accurate test.

(p. 234) Q. Okay, and are the exhibits before you the copies of what you sent out?

A. Yes.

Q. Exhibit No. 45 and Exhibit No. 44?

A. Yes, they are.

Q. Okay, and these envelopes contain blanks in this window. Would the address of the person to who it's sent to appear in that envelope?

A. Yes, their name and address.

Q. Who would put the labels on?

A. The letter shop—the people that I would hire to actually do that mailing for us.

Q. Okay, and can you tell—describe or show the Court what the difference between the test that was your control test and the one testing for sales tax response is?

A. The mailing pieces are identical, except for the order card, which is the response vehicle. This is the part that the person would return to us saying that they wish to subscribe.

Q. Why don't you show it to him since he's the one that needs to see.

A. The only difference is that there's a little asterisk there, and down here that says (p. 235) "plus tax."

Q. Can you show the control card to show the contrast, and the control card is Exhibit No.—one of them has an asterisk that says plus tax and one of them doesn't?

A. That's correct.

Q. In the package of materials that were mailed, which contains some letters and other things, was there any other reference to taxes?

A. Yes, in the letter.

Q. Would you show for the Court the two letters and how they differ, and when you do that, refer to their exhibit number, if you would, please, for the record. There's several—there's a deposition exhibit and an exhibit—

A. It's 44D and 45D. It's the same type of thing. It's just an asterisk in one of the paragraphs next to the price, and then in the lower left-hand corner the asterisk again says "plus tax."

Q. Was there any difference in the kinds of people or the lists of people you sent out Exhibit 45, as opposed to Exhibit 44?

A. No, they were randomly selected.

(p. 236) Q. Now, what was the response difference of the orders that you got back?

A. The net response, which means the people that respond and pay for the subscription—the results show a 25 percent decrease for the test panel with the tax.

Q. Now, is the 25 percent decrease in the responsiveness to your direct mail solicitations important to your ability to survive as a viable economic entity?

A. Oh, absolutely.

Q. What—can you describe for the Court what economic effect that would have on the operation, if you were to continue only to have such a decrease in responses?

A. Well, the magazine publishing business is based on a rate base, which is guaranteed to our advertisers. In our case it's 60,000. We have to make sure we furnish 60,000 paid readers to our advertisers. In order to do that, we constantly have new subscription acquisition promotion. At the present time, that costs me a minus $20 a subscription. In other words, we lose money on every subscriber.

Q. It costs you $20 more to get a (p. 237) subscriber through the various direct mail packages than they bring in in subscription revenue?

A. That's correct.

Q. Okay.

A. So if I decrease my response by 25 percent, the cost to get those subscribers goes up in relationship to that. So it would be a very large economical problem for us.

Q. And the number of your—the rate base for your subscription rate base would go down?

A. Yes, I'd have to put out a lot more mail to make up those 25 percent of the people that I lost, and that would be very, very expensive.

Q. And what would be the effect of simply reducing your rate base?

A. We would lose advertising, and we wouldn't be able to charge our advertising rates.

Q. Is the rate that an advertiser pays based on the number of thousands of readers there are?

A. Yes, it's a cost per thousand.

Q. So if you have 25 less percent—(p. 238) you had 40 percent—40,000—a rate basis of 60,000, your price for a page of advertising would be reduced significantly?

A. Yes.

Q. Okay. Now, in connection with the—

MR. GEORGE: Well, first of all, I'll offer Exhibits 43—

MR. MENDEZ: No objection.

THE COURT: It will be admitted.

MR. GEORGE: —and 44 and 45, which have subparts A through D.

MR. MENDEZ: No objection.

THE COURT: They're admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, magazines are—are you familiar with magazines from out of state that are mailed to Houston residents?

A. I know of magazines that are mailed from out of state to Houston residents.

Q. And do you compete with those magazines in any way?

A. At times, yes.

Q. And do you compete for subscribers?

(p. 239) A. Yes.

Q. With those magazines?

A. Yes, I do.

Q. Now, based upon your experience in the industry and your experience—you lived in New York, did you not?

A. Yes, I did.

Q. And you worked there for 15 years in the direct mail publishing business; is that right?

A. Yes.

Q. Did the magazines that you're familiar with that are based in New York that are sent in to Houston collect sales tax from Texas readers?

A. Not to my knowledge.

MR. GEORGE: Thank you very much. That's all of the questions that we have at this time.

CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Ms. Tiemeyer, do you have a sales and use tax permit? Does your corporation maintain a sales and use tax permit?

(p. 240) A. I don't know.

Q. Okay, and do you know whether or not you remit a Texas sales tax?

A. To my knowledge, we did.

Q. Okay, and do you know how they calculate—how your corporation calculates that tax?

A. From information gathered from our fulfillment company. That's how we paid it. We try collecting it through our billing series.

Q. You try doing what?

A. To collect the tax through our billing series.

Q. Okay. Do you know if your fulfillment house has the capacity to record whether or not sales tax was collected or use tax was collected on a specific magazine?

A. I believe that they do.

Q. What's the name of the company?

A. Fulfillment Associates, Incorporated.

Q. And that's in New York; right?

A. That's correct.

Q. Okay, and aside from this test panel that you are testifying to today, which is your Exhibit No. 44, have you ever included a (p. 241) reference to sales or use tax in any of these previous solicitations?

A. No.

Q. Okay. So do subscribers—to the best of your knowledge, do subscribers include or calculate the sales or use tax that's due and send it in along with their order form

to your fulfillment house, even though they don't have a reference to it or indication that sales or use tax is due?

A. The fulfillment—most of our orders come in as "Bill me." So a bill is then sent out, and our fulfillment company prints the amount of the tax on the bill so that the subscriber knows exactly how much he or she has to pay.

Q. And do you know or do you have any reason to know whether or not the fulfillment company receives or does not receive the amount of taxes—the amount of the subscription that's billed?

A. Our corporate controller in Dallas has been keeping track of this, and approximately 50 percent of the subscribers do not pay the sales tax.

(p. 242) Q. Okay, and does your magazine—does your publisher make a business decision not to stop sending the magazine to those persons that didn't remit the tax?

A. I'm sorry. Could you repeat that?

Q. Does your magazine continue to— does your publisher continue to send copies of that magazine to persons that did not remit the use tax?

A. Yes, we have no choice but to do that.

Q. Why don't you have a choice?

A. Because we cannot afford to lose the paid subscriber and have our rate base suffer.

Q. Is it your understanding that the corporation then picks up the sales or use tax for that person that didn't remit it and remits it to the State for them?

A. That's my understanding.

Q. And you're not going to send out a letter, are you, to that person who forgot to send you the 60 cents or the 50 cents to tell them to send that in to you?

A. We have not done that so far.

Q. From your business experience, would (p. 243) that be an economical way to handle the noncompliance by those persons?

A. Probably not but I don't know.

Q. Okay, ma'am, could you explain what the demographics of the group are—the profile of the group that you tested in this testimony that you've given today?

A. Yes. Our average age of our reader is 38 years old. Half of our file is male and female. The average income is about $55,000. About 80 percent of our readers are in top management positions. 82 percent have either gone to or completed college. That's the type of demographics that we look for.

Q. And if I told you that I had a list to rent to you and it had a group of persons on it whose median age was about 40 years and they made over $40,000 a year and half of them were men and half of them were women and most of them are married and most of them have college educations or graduate work, would that be a list that you might be interested in, in order to subscribe to —I mean, to approach them for sales of *Houston City?*

A. I would be interested in testing (p. 244) that list, yes.

Q. And would you say that if somebody sold subscriptions to that group that they were—here in Texas and maybe persons that might be located in Houston with those demographic profiles that they would be competing with you for sales of magazines?

A. I'm sorry. Could you repeat that? It was a little long.

Q. I don't know if I can. If I told you that I was selling a magazine to somebody in Houston that had that demographic profile, which I just described—you know, 40 years and all of that, would you have a reason to believe that I'm competing with you for that person in the magazine business?

A. If your editorial content was the same as mine, yes.

A. And to the best of your knowledge— well, are you familiar with *Texas Monthly?*

A. Oh, very, yes.

Q. Okay. Would you consider that to be a magazine whose editorial content would be the type that you might compete with?

A. Editorially and advertising-wise (p. 245) *Texas Monthly* is a competitor of ours.

Q. Okay. Ma'am, why did you pick 10,000 persons?

A. It's a good test size.

Q. Is a bigger test size any better?

A. Not on a 400,000 mailing list, no.

Q. Okay. Well, what's a good universe to use of —what would be the minimum size of a mailing list that you would use as a universe for some test like this?

A. You could do it with 200,000 names and test 5,000 of them. It depends. I mean, it's a local market. We don't have 2,000,000 names to send to.

Q. Okay. Does the number of names in the universe and in the actual sample tend to increase the accuracy of your estimate or not?

A. Say it again.

Q. Does a larger universe and a larger sample in your tests indicate a more accurate figure or result?

A. No.

Q. And why is that?

A. Because it's proportionately a correct testing group.

(p. 246) Q. So you could test two people, and if you got one response, that's as good as 10,000 and if you got, you know, a thousand responses?

A. No, it would not be the same, if you were just testing two people.

Q. Okay. Well, what is a good test size is what I'm asking you from your experience?

A. 10,000 test pieces is an accurate sampling to get accurate results.

Q. In your tests what was the difference between the person—in response rate between the persons that responded to the test panel and those that responded to the control panel?

A. May I see the exhibit?

Q. It's Exhibit No. 43, and I don't have it. I mean, I've got a copy, but I don't have it here.

(At this time there was a brief discussion off the record.)

QUESTIONS BY MR. MENDEZ:

Q. Do you have that exhibit in front of you now?

A. Yes, I do.

(p. 247) Q. Okay. Did you conduct that test?

A. Yes, I did.

Q. What was the percentage difference in the response rate between the persons that responded to the test panel and those that responded to the control panel?

A. The net difference was 2.9 percent—2.9 percent, which is a 25 percent decrease.

Q. So 25 percent less people responded to your test panel than to your control panel?

A. Yes.

Q. Okay, and now, that's your net response, is that correct?

A. Yes, that's correct.

Q. What was your gross response?

A. The gross response—the difference was .18, which is an eight percent decrease.

Q. Okay. Was this a cash offer, or this was a credit offer?

A. It was a credit offer.

Q. Okay. Do you have any—what is the explanation for—if you know and from your experience in this industry, why there's such a difference between gross responses and net responses?

(p. 248) A. Well, in general this was a first issue free offer, and it was also a credit offer. So usually you'd get fewer people paying than responded to begin with. In this particular case, I believe the greater decrease between gross and net was due to the bills going out and showing the tax on it.

Q. Okay. What—is there a different response rate for different types of terms and prices?

A. Yes, a hard offer, which is not a first issue free, has a lower gross response and a higher net response.

Q. What if you had an issue—an offer which was two free issues of the magazine plus a term of 12 months, if you pay cash right now, or you'll just get the 12 months, if you buy it for credit?

A. You'd have—well, say that again. If it was a cash—

Q. Are you familiar with the test that *Texas Monthly* conducted that's similar to the one that you did?

A. No, I'm not.

Q. Okay. If I told you that I was (p. 249) going to make an offer that was for a term of 14 months and that I'd give the person two free copies if he sent me the cash right away and then if he did want to pay cash that he could have 12 issues for that same price, do you know that kind of a test—I mean, that kind of a term would have a similar response to the one that you have here in your test?

A. If what you're saying is that they get two issues extra but they must send the cash with the initial order, they would have a lower gross response and a very high net response because the cash would have been received up front.

Q. People tend to be less responsive to cash—to sending in cash?

A. That's correct.

Q. Okay. About how many of these tests have you conducted in your career?

A. Just tests—not tax tests; correct?

Q. Well, just different terms and prices and things like that.

A. I'd say several hundred.

Q. Okay, and is that—you were in the direct mail business for a long time. Is that (p. 250) something that's normally done by direct mail outfits?

A. Yes.

Q. And you take a control panel and then you run a test panel against it on a certain sample of people?

A. One or several tests.

Q. Okay. How long have you been with Southwest Media?

A. A year and a half.

Q. Now, ma'am, does your magazine sell advertising space?

A. Yes, it does.

Q. Okay. Does it compete for advertisers with *Texas Monthly*?

A. Yes, it does.

Q. Okay, and is it a—was it a business decision of the corporation to use this reference to tax in its normal control panel for solicitation after you ran this test?

A. After we ran the test based on the results, we decided not to put any reference to sales tax on our subscription acquisition promotion pieces.

Q. Have you ever used that—aside (p. 251) from this particular test, have you ever made references to the use tax or sales tax collection in any of your solicitation material?

A. No, not other than this.

Q. So this is the only experience that you have with respect to the effect on your circulation of putting those words in?

A. That's correct.

Q. Okay, and you mentioned that this would have an economic effect on your corporation. Can you tell the Court exactly how much money Southwest Media would lose through the end of this fiscal year, if it used that type of a—that type of language in its solicitation?

A. No, I could not give you a dollar amount off the top of my head, but it would be proportionate.

Q. And in fact, it's not going to lose any money because they're not using that type of a solicitation device, are they?

A. No.

Q. Okay, and it's a business decision of the company to not attempt to collect a tax from the individuals; is that correct?

(p. 252) A. No, that's not correct. We attempt to collect it via our billing series.

Q. Okay. So to the extent that purchasers buy it on credit and that you can get the money from them when you send them the bill, then to that extent you attempt to collect it?

A. That's correct.

Q. Okay. If a person does not comply with your initial bill, then you don't stop sending him the magazine. You just eat the tax?

A. That's correct.

Q. Okay. From your experience in the direct mail business and in the magazine business, do you know how many fulfillment houses there might be in the country?

A. No, but I'd say at least 50.

Q. Okay. Do you know which ones—any of them that might be able to calculate or incorporate tax calculations into—tax collection mechanisms into their computer programs?

A. I don't know of any that have that. I'm sure they could do it.

Q. But you've mentioned that your fulfillment house in New York can calculate that (p. 253) and indeed does calculate that for your company; is that correct?

A. That's correct.

Q. Okay, and what is the percentage of income from advertising that your company experiences, as compared to the total revenues of the—from that magazine?

A. I'd say it's about seven times as great—the advertising revenue is seven times as great as the subscription revenue.

MR. MENDEZ: Pass the witness.

REDIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Ms. Tiemeyer, let me get something straight. You send out these solicitations and ask people to buy on credit; is that correct?

A. That's correct.

Q. And you have been sending out bills to the people that show—what's your basic subscription rate?

A. $15.

Q. —$15, and then they add—plus the tax?

(p. 254) A. That's correct.

Q. Plus whatever that is—60, 70 cents, 75 cents tax or something like that?

A. Thereabouts.

Q. And you told the Court that 50 percent of the people refused to pay the tax?

A. That's correct.

Q. They remit the balance and don't pay the tax?

A. That's right.

Q. And that's been going on for a year?

A. That's correct.

Q. Given the fact that your subscription revenue is seven times—I'm sorry—your advertising revenue is seven times your subscription revenue, is there any way you can economically force somebody to pay the tax, if they choose not to?

A. No.

Q. And 50 percent of the people simply don't—refuse to pay the tax?

A. That's correct.

Q. Do you know whether that is affected by the fact that they don't have to pay the tax if they subscribe to magazines like *Reader's* (p. 255) *Digest* and those kinds of magazines?

A. I don't know.

MR. GEORGE: That's all of the questions I have of this witness. Thank you very much.

RECROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. I have a couple of questions. Ms. Tiemeyer, has your corporation been involved in any lobbying efforts with the Texas Legislature to try to amend this statute so as to correct this supposedly—

THE COURT: This is interesting, but it looks like that's irrelevant.

MR. GEORGE: I was going to object on that basis. It's irrelevant and—

MR. MENDEZ: No further questions.

MR. GEORGE: Your Honor, I have a witness by deposition, a Mr. Bullock, and we can put that on in the federal court manner by simply referring you to line and pages and having you read it, if you wish, or I can have it read question and answer at your—since (p. 256) this is a bench trial, whichever way you want to do it.

THE COURT: It might be quicker if we read it and I listen to it. That way—

MR. GEORGE: Okay.

THE COURT: Are you offering all of it?

MR. GEORGE: No, sir, I'm offering only—or most of it but it's—it will take a few minutes, and can I—

THE COURT: If you're offering all of it, I would accept it that way, and I'll read it, but if you're going to pick and choose, I'd rather you—

MR. GEORGE: Okay. I have marked it—part of it. Can I borrow your copy? My other copy is at the—

MR. MENDEZ: Why don't we just agree to introduce the whole deposition? I don't have a problem with it.

MR. GEORGE: Well, you asked the questions, and some of your questions aren't admissible, Mr. Mendez.

MR. MENDEZ: Why don't you— (p. 257) well—

MR. GEORGE: I'll just read it to the Court.

THE COURT: All right.

MR. GEORGE: Beginning on page four, questions by Mr. Mendez. This is the deposition of Scott Bullock taken on January 28th, 1986 in Austin, Texas at 2300 InterFirst Tower, offices of Graves, Dougherty, Hearon & Moody. The witness was sworn.

THE COURT: I don't guess I've got it up here.

MR. GEORGE: I'm going to give him this one and let you and I read that one.

Beginning on page four, line two. Question by Mr. Mendez.

"Please state your full name for the record, sir.

"Answer: Scott Arthur Bullock.

"Question: And where do you reside?

"Answer: In Dallas, Texas.

"Question: And with whom are you employed?

"Answer: Southwest Media Corporation.

(p. 258) "Question: And could you give us the business address of that?

"Answer: 3988 Northcentral Expressway, Suite 1200, Dallas, Texas 75204."

Stop on line 12, page four. Go to line 17, page five. Question again by Mr. Mendez:

"What is your position with Southwest Media Corporation, sir?

"I'm circulation director for *D Magazine*.

"Question: Is that a publication that is published by the corporation?

"Answer: That's correct.

"Question: And that's *D Magazine*?

"Yes.

"And how long have"—

"Question: And how long have you been circulation manager or director for that entity?

"Answer: I have been circulation director for nine months.

"Question: And what are your duties as circulation director for *D Magazine*?

"Answer: You could—could you be more specific?

"Question: Well, what do you do in your (p. 259) job as circulation director for the publication? What are your responsibilities?

"Answer: My job is to sell subscriptions and to service subscriptions.

"Question: And do you do this as an employee of Southwest Media Corporation?

"Answer: Yes.

"Question: Are you an officer or director of that corporation?

"Answer: No, I'm not.

"Question: Are you just an employee that works with *D Magazine*?

"Answer: That's correct."

End line 21, page six. Go to line five, page seven.

Question by Mr. Mendez:

"How long has Southwest Media Corporation published D—the magazine D?

"Answer: I believe 11 years.

"Question: And what type of articles or materials are contained in the general sense in this publication, *D Magazine*?

"Answer: Mostly articles that pertain to living in Dallas.

"Question: And that format has been (p. 260) maintained throughout the 11 years, to the best of your knowledge?

"Answer: Yes, sir.

"Question: How long have you been with Southwest Media Corporation?

"Answer: I already answered that—nine months.

"Question: So you didn't work for them prior to the time that you had worked as circulation director?

"No.

"And where were you employed prior to that time?

"I was employed by Xerox Corporation.

"And—Question: And they are in Dallas?

"Answer: That was in New York.

"Question: And what was your position there?

"Answer: I was circulation promotion coordinator for four trade titles.

"Question: And what were those publications?

"Answer: *Publisher's Weekly, Library Journal, School Library Journal,* and *Small Press* magazine.

(p. 261) "What type of profession or trade uses those types of publications?

"Answer: The publishing community and libraries principally.

"Question: What is the circulation of *D Magazine*?

"Approximately 80,000.

"Question: And I would say this is the current—this would be the current circulation of that magazine?

"Answer: That's correct.

"Question: Do you have occasion to review ABC reports or Audit Bureau of Circulation reports with respect to the circulation of *D Magazine*?

"Answer: Yes, I do.

"Would you identify for the Court approximately how many or what percentage of those 80,000 publications are sold outside the State of Texas and what percentage is sold within the State of Texas?

"Answer: Outside the State of Texas approximately one percent—less than one percent.

"Question: The rest of them all in Texas?

(p. 262) "Answer: That's correct.

"Question: Can you identify for the Court what percentage of these magazines are sold by subscription, as opposed to sold to newsstands or other retailers of magazines?

"Answer: Percentages?

"Question: Yes, sir.

"Answer: Approximately 20 percent are sold that are not subscriptions.

"Question: So 20 percent of them may be sold to other retailers that may sell them over the counter? Is that a fair statement?

"Answer: Approximately.

"Question: So that 79 or 80 percent would be persons that subscribe to your company for issues of the magazine?

"Answer: Approximately."

End page nine, line 24. Go to line—page 13, line 11.

"Question: How could you describe how your direct mail promotion scheme made it to a potential purchaser, if it did?"

THE COURT: What page are you on?

MR. GEORGE: Page 13, line (p. 263) 12, again questions by Mr. Mendez.

Question by Mr. Mendez: "Now, would you describe how your direct mail promotional scheme made it to a potential purchaser, if it did— what their use tax liability would be for the purchase of the magazine, if you have done that?

[sic] "I'm not sure I understand the question.

"Question: I assume that by direct mailing you are sending a particular subscriber a letter saying these are the reasons why you should subscribe to my magazine, and here is a price for you to buy it at. Is that a fair statement?

[sic] "Yes."

An objection by Mr. George: "Are you asking about the test that involves a reference to sales tax and the one that didn't involve sales tax?"

Interchange by Mr. Mendez and Mr. George. Skipping to—on page 14 to line ten. Question by Mr. Mendez:

"In using these various solicitation schemes, have you and your company made a test to determine what the effect would be of identifying to the taxpayer the need to remit (p. 264) use tax for the purpose of a subscription to *D Magazine*?

"Answer: We have made a test regarding sales tax.

"Question: Could you explain for the Court how that test worked?

"Answer: We mailed a subscription package to a list of lists, and the test was conducted in such a way that we mailed a certain number of packages with one offer in it, and we mailed the same package with the same offer, the same term, same price, but we mentioned sales tax in it, to determine if by mentioning sales tax it would have a positive or negative effect on a subscriber's decision to purchase the magazine.

"Question: And what constituted this solicitation package or this promotion package? Could you describe what documents would have been included in it?

"Answer: Yes, there is a carrier envelope. There is a postage paid return envelope. There is a letter, and there is an order card.

"Question: How was the subscription (p. 265) price offer relayed? Did it say something like 12 issues for eight plus tax—$8 plus tax or something like that?"

Interjection by Mr. George, "Do you have the cards with you?"

"The witness: Yes, I brought samples with me to be entered in—into. This one here is one that we call control panel, and that has been proven, over time over a series of tests to be one of our most successful approaches, and this one is where we mentioned again that the price being the same, the term being the same, but there is an asterisk that says 'plus sales tax,' " and when I'm going —so we can go through this in orderly fashion I'm going to have the court reporter mark both of these documents as Exhibit 1—or Bullock Exhibit 1 and Bullock Exhibit 2. At this point I will remove from this deposition transcript Bullock Exhibit 1 and Bullock Exhibit 2 and ask our court reporter to mark them as exhibits here.

(At this time the instruments referred to were marked as Plaintiff's Exhibits Nos. 46 and 47 for identification.)

(p. 266) MR. GEORGE: Going on, page 16. Questions by Mr. Mendez:

"Now, sir, we have marked for your deposition Exhibit 1. Could you identify that document for the Court? That is the control panel."

MR. GEORGE: I'll now offer Plaintiff's Exhibit 46.

THE COURT: Admitted.

MR. MENDEZ: No objection.

MR. GEORGE:

"Question: Is that an item that was included in the subscription package that you just testified about?

[sic] "Yes.

"Question: And is that particular exhibit the one that included tax or not—or not?

[sic] "That is—that is one that does not include tax.

[sic] "Now, to how many persons—potential subscribers was this document sent?

"Answer: 25,000.

[sic] "And from what type of list or from what list did you derive the name—the names of the (p. 267) 25,000 persons to whom Bullock Exhibit No. 1 was sent?

"Answer: There is a list of approximately 36 different lists—36 to 40 different lists that we used.

[sic] "And are these lists that are maintained by Southwest Media Corporation?

"Answer: No.

[sic] "Who owns or has custody of these lists?

"Answer: Various magazines.

"Question: Since they were in the custody or ownership of various magazines, how did you get access to them so that you could get addresses to mail that to?

"Answer: We rented them.

[sic] "Was there—was the mailing conducted by your office?

"Answer: Yes, it was.

"Question: Were all of these 25,000 persons that were derived from the list that were rented located in Texas?

"Answer: Not necessarily.

"Question: Could you describe for the Court what geographical area these people might have been located in?

(p. 268) "Answer: Are we talking about the potential recipients, or are we talking about the companies?

"Question: Well, the testimony has been that you had 25,000 mail-outs of Bullock Exhibit 1 to persons whose names and addresses showed up on the list, and what I'm interested in, sir, is do you have a way of knowing whether the 25,000 persons to whom these publication subscription offer was mailed were located in Texas or not?

"Answer: Yes, absolutely.

"Question: And you say that most of these people were in Dallas, Fort Worth area?

"Answer: Yes.

"Question: What else went along with Bullock Exhibit 1? If you have anything handy, did you bring anything else that was included in the subscription package that went with Bullock Exhibit 1?

"Answer: No.

"Question: So it included a letter explaining the offer, I gather; is that correct?

"Answer: That's correct.

"Question: Did the letter include any (p. 269) paragraph or sentence regarding the liability or non-liability of the user for sales tax and your responsibility for collection—collecting that use tax?

"Answer: In regard to Exhibit 1?

"Question: Yes, sir.

[sic] "There was no mention of sales tax.

[sic] "So there was no mention of the applicable sales or use tax in any part or any narrative in the mail-outs that went out to the 25,000 people that included Bullock Exhibit No. 1?

"Answer: No mention of sales tax.

"Question: Mr. Bullock, I hand you what has been marked as Exhibit No. 2. This is the one that is identical to Bullock Exhibit No. 1, except that it had plus sales tax asterisk on it?

"Answer: That's correct."

MR. GEORGE: I'll offer Exhibit 47, which is the same document referred to in the deposition as Exhibit 2 —Bullock Exhibit 2.

MR. MENDEZ: No objection.

THE COURT: Admitted.

MR. GEORGE: Now, (p. 270) beginning on page 19, line eight again continuing on that page.

"Question: And did you mail out to 25,000—and did you mail out to 20,000 persons also?

"Answer: No, we mailed it to 10,000.

"Question: And were these 10,000 persons derived from your list of lists?

"Answer: The same list as in Exhibit 1.

"Question: But I gather that you didn't send one of these—one of each package to each individual? You wouldn't do something like that? It was different individuals that it was sent to; is that correct?

[sic] "That's correct.

"Question: Now, were these people— these persons also the same—in the same geographical area as the 25,000 persons that was on Exhibit No. 1?

"Answer: Yes, they were.

"Question: Is there a specific reason why only 10,000 persons were contacted, as opposed to 25,000 persons?

"Answer: No.

"Question: Was there a recordation by (p. 271) your company—by your corporation or by persons to your corporation of responses to the package—the packages that are included in Bullock Exhibit No. 1?

"Answer: I'm sorry. I don't understand the question.

"Question: Did someone in your company maintain a list of how many people responded to the promotional package that included this Bullock Exhibit No. 1?

[sic] "Yes.

[sic] "And what were the results of that exercise?

[sic] "We received 506 gross responses.

"Question: To the 25,000 mail-outs?

"Answer: That's correct.

"Question: Did you calculate what percentage that was of the total?

"Answer: That was approximately two percent.

"Question: Is that particular response—well, let me ask it this way: Was there any change in the rate in previous offers that might have been made of the magazine in this particular promotional scheme?

(p. 272) "Answer: I don't understand the question.

"Question: Was there a change in the rate from previous subscription rates, if we are looking at Bullock Exhibit No. 1 and it says here that you can get 12 issues for 8.95; is that correct?

"Answer: That's what it says.

"Question: Is that the same subscription rate that might have been offered on previous promotional schemes that would have attempted to sell this magazine?

"Answer: Yes.

"Question: So there wasn't any change in the price? It was just a mail-out at the same basic price or offer that you make; is that correct?

"Answer: That's correct.

"Question: Now, is the two percent response—well, you mentioned that it was a gross response. I gather then that there was some deduction from that? What does that mean?

"Answer: Some people pay their bills and some people don't.

"Question: Does the gross response represent a meaningful measure for your (p. 273) publication of how many—of what the response is to the solicitation scheme?

[sic] "Yes, it does.

"Question: So two percent that in—so two percent that in line with your previous experience as to how many people subscribed out of a total solicitation offer?

[sic] "That's in line.

"Question: That's pretty normal; is that correct?

"Answer: Yes.

"Question: Now, was there a similar cataloging of the results of solicitation efforts that are covered by Bullock Exhibit No. 2 or that included Bullock Exhibit No 2?

"Answer: Yes.

"Question: And can you explain for the Court what your gross response was?

[sic] "For Exhibit 2?

"Question: Yes.

"Answer: The gross response was 117 orders, and the gross response percentage response was 1.1 percent.

[sic] "Was there a net response rate on that on Exhibit 2?

[sic] (p. 274) "Yes, that was calculated. Yes —

"Answer: Yes, it's .9 percent.

[sic] "And what was the net response rate on Exhibit 1?

[sic] "On Exhibit 1 it was 1.1 percent."

Stop. Go to page 23, line seven. Questions by Mr. Mendez:

"I want to go back to this experiment. I gather you don't normally do this type of solicitation differentiation; is that correct? You can't—you don't usually break down your solicitation efforts into various categories and see which one works better?

"Answer: Yes, we do.

"Question: Do you do that pretty regular?

"Answer: Yes.

"Question: And what other types of situations have you tested in this manner?

"Answer: Well, we test different packages against each other. We didn't do that in this case. We test different lists. We test different terms, meaning 12 issues, 14 issues, 16 issues. We test different price—8.95, 9.95, 10.95.

[sic] "And you had to conduct a test like this (275) before for your corporation; is that correct?

[sic] "Yes.

"Question: Does the management of Southwest Media Corporation, in deciding who might be potential subscribers to *D Magazine*, target a specific group of people—persons with a specific demographic profile?

"Answer: Yes.

"Question: If you could generalize for the Court, what type of demographics would describe the person the management of Southwest Media Corporation would target as a buyer?

"Answer: Someone who is educated.

"Question: Any other criteria?

[sic] "Age approximately 36 to 44, attended college.

"Question: Any criteria regarding how much money they make or not make?

"Answer: Anywhere from 25,000 to a million.

"Question: What efforts does Southwest Media Corporation go through to determine whether or not a particular list contains names of persons that meet the demographic requirements?

(p. 276) "Answer: We work very closely with professional list brokers who, like stock brokers, are well versed in the list business and provide data on the subscriber files.

"Question: So if you say you want a list of college graduates that are 36 to 44 that make incomes over $25,000—25,000, it's possible to go out and buy that from a professional list broker?

"Answer: It's possible.

"Question: And Southwest Media does this on a regular basis?

"Answer: We do things like that.

"Question: Would the persons that were contacted in this test—35,000 persons that were contacted on this test, which you have been giving testimony about this afternoon—would they be characterized as persons that meet these demographic requirements?

"Answer: I hope so.

"Question: I'm trying to be fair in my questioning. Would it be fair to say that you wouldn't have wasted your time mailing to people who didn't fit within these demographic requirements?

(p. 277) "Answer: That's true.

"Question: There are certain costs that go with this, and you are trying to get a certain response rate and that —and you wouldn't waste your time giving it to persons that wouldn't respond?

"Answer: We would test it but generally speaking we would not waste our time.

"Question: Sir, in your experience in previous tests, let's say, on price differentials—charging a different rate —an increase in price or decrease in price or testing for the responsiveness to that, would the number of persons have been similar to this?

"Answer: I'm sorry. I didn't catch that.

"Question: What I'm asking is is the size of the group that you test, 35,000, a normal size of a group—normal size of a group to test in a situation where you are testing for price differentials?

"Answer: Oh, yes.

"Question: Would it be similar for term differentials?

"Answer: Yes."

Continuing on page 26 with(p. 278) line 18.

"Question: Are there any situations that you can think of where you would use a test group of this size?

"Answer: There are many situations in which—

"Question: Where you would not use a test group of 35,000 persons or so to figure out what the responsiveness would be to a particular specific type of solicitation scheme?

"Answer: No, that size of 10,000 or more is generally statistically valid." Valued, I think it is. I think that's a misprint, but in any event—

"Question: And there again there is no basic—can you identify any reason why you tested less persons with a card that was Bullock Exhibit 2, as opposed to the persons that got Bullock Exhibit No. 1?

"Answer: No, I can't.

"Question: Did you make that decision, or did someone else in the firm make that decision?

"Answer: I did not make that decision."

Skipping to line 24 on (p. 279) page 27. Question by Mr. Mendez:

"Do you know—how long does a test like this take to perform? In other words, if you send out the cards today, when do you stop measuring responsiveness?

"Answer: We never stop measuring.

"Question: Do these have an expiration date on them?

"Answer: No, they don't.

"Question: So that you might still be getting responses to that particular direct mail offer that was issued in January of 1985?

[sic] "It's possible but not probable.

"Question: In your experience in the circulation department, about how long would it be reasonable after you sent out a direct mail scheme like this to still consider to be receiving responses from that?

"Answer: I would say one year.

"Question: Is this price still the same?

"Answer: Of what?

"Question: Well, Bullock Exhibit 1 indicates that for a term of 12 issues the basic subscription offer rate is 8.95. Is that still the rate that you offer the rate on?

(p. 280) "Answer: That is one of the rates.

"Question: Different solicitation schemes have different prices?

"Answer: That's correct.

"Question: Are you aware of any solicitation schemes that are offered for the 12-month term at a rate higher than that?

"Answer: Yes.

[sic] "Do you know if that might have been tested to determine the public's responsiveness to that offer?

"Answer: Yes.

"Question: Do you have any results of what affect the different rate had on responsiveness?

"Answer: I do not with me.

"Question: Can you tell the Court generally what that effect was?

"Answer: The higher the price the less likely someone is to buy it.

"Question: And you—and are you familiar with the manner in which Southwest Media Corporation reports and remits the sale or use taxes to the Comptroller of Public Accounts?

"Answer: I do not. That's a question (p. 281) for our Comptroller.

"Question: And do you have anything to do with receiving or recording offers, acceptances of your solicitation offers from the public?

"Answer: I am not sure I understand your question.

"Question: In other words, once you sent the package out, which included Bullock 1 or 2, do you have any

responsibility in the corporation for getting back the responses and recording them anywhere?

THE COURT: Are you getting a little thirsty? We can stop, if you want to. I'm not—you know, it's—I can go a little bit longer. Whatever you—

MR. GEORGE: Why don't—can we do ten minutes to see if I can finish this today so I don't have to start with it in the morning?

THE COURT: Sure.

MR. GEORGE: Beginning I think, on—may I sit down?

THE COURT: Sure.

MR. GEORGE: Beginning on (p. 282) page 30, line one.

"Question: In other words, once you sent this package out, which includes exhibit—Bullock's 1 or 2, do you have any responsibility in the corporation for getting back the responses and recording them anywhere?

"Answer: Yes, for testing purposes.

[sic] "Is that the reason you would use it or just general business purposes?

[sic] "Both.

"Question: So these responses for persons that want —say, the 506 people that were gross responses to the 25,000 in mail-out—did those come directly to your office?

[sic] "Yes.

[sic] "And what did you do with them?

[sic] "They are sorted and counted and then mailed out to the fulfillment house for final processing.

"Question: And the fulfillment house would then take care of making sure these people get the magazine?

"Answer: They are responsible for inputting the data into a computer system and producing labels that ultimately are put on the (p. 283) magazines so that they can be shipped.

"Question: But you have no responsibility for recording the revenue that may accompany an acceptance of the offer?

"Answer: I am not really sure I understand that question.

"Question: Okay. If you get these 506 responses back to your office, would my money accompany those in payment for the subscription?

"Answer: Would the money accompany?

"Question: Yes.

"Answer: Sometimes.

[sic] "And what's your responsibility with respect to recording that on the books of the corporation, if you have any responsibility?

[sic] "As far as accounting purposes, I have no responsibility.

"Question: So you have—so you just ship it over to the cashier or something like that?

"Answer: It's shipped out to the fulfillment house who then processes it.

[sic] "And who is the fulfillment house for Southwest Media Corporation?

"Answer: Fulfillment Associates, (p. 284) Incorporated.

[sic] "And where are they located?

"Answer: Farmingdale, New York.

"Question: In the course of your job as circulation director for *D Magazine,* do you have any knowledge as to how Fulfillment Associates, Inc. records—you know, well, records the use tax or sales tax that may be applicable to the sale of *D Magazine?*

"Answer: I do not."

Continuing with Mr. Mendez' questions on page 32, line 11.

"We are back on the record, sir. We have a question of value, and it's your business. So we really don't understand how your business works, but in arriving or compiling this list for 25,000 persons that you sent Bullock Exhibit No. 1 to, did you buy up lists or parts of lists that were owned or you rented them from your—from other individuals or other companies so that you got up to a total number of 25,000 names to mail it out to, or did you buy some larger quantity of lists and then randomly take names out of there that you might send the promotional scheme to?

(p. 285) "Answer: We rent lists to arrive at a certain gross quantity. Then on a random, what we call, Nth name selection, a random selection is then pulled from each of those lists to compose the test scheme."

Going to page 35, line 15.

"Question: And do you have an opinion from your review of this test as to whether or not it would have affected the company in some way?

"Answer: Yes, I have an opinion.

"Question: And what is that?

[sic] "My opinion is that the mention of an additional cost in the form of sales tax has a negative impact on a subscriber's decision to buy the publication.

"Question: Do you know what the management of Southwest Media Corporation did in response to the results of this test?

[sic] "What they did with it?

[sic] "Did they use them in setting up their business operations for *D Magazine* or any other magazine in Texas?

[sic] "I'm not sure I understand the question.

"Question: As a result of the experience (p. 286) that are generated by this test, do you know if Southwest Media decided to include this as a regular part of their package—the asterisk with the plus tax included or whether to eliminate it from all promotional schemes?

[sic] "I only know in regard to *D Magazine*.

[sic] "Okay, sir, and what was the management's decision?

"Answer: The management's decision was that because it had a negative affect on the subscriber's decision whether or not to purchase a publication to not mention sales tax.

"Question: Do you know how Southwest Media Corporation has decided to handle the reporting and remitting of the applicable sales and use tax for *D Magazine?*

"Answer: That's a question for the Comptroller.

"Question: So you have no knowledge right now of how Southwest Media calculates and reports taxes to the Comptroller?

"Answer: No, that's a question for the Comptroller."

Questions on page 37, line seven by Mr. Mendez:

(p. 287) "Sir, in the course of the deposition you have been referring to a document which you have with you, which I assume is a summary of the results of your experience, is that correct, regarding this test?

[sic] "Yes.

[sic] "Can I look at it?

[sic] "Absolutely."

Questions by Mr. Mendez, page 37, line 16:

"We are back on the record, sir. We have now had marked as a document, which you have read, Bullock Exhibit No. 3."

(At this time an instrument was marked as Plaintiff's Exhibit No. 48 for identification.)

MR. GEORGE: That document is now marked Plaintiff's Exhibit 48.

The answer to the previous question:

"It's just a brief summary of the results of the campaign in question and"—

The next question: "And did you prepare this document yourself?

[sic] "Yes, I did.

(p. 288) MR. GEORGE: I will offer Exhibit No. 48 —Plaintiff's Exhibit 48.

MR. MENDEZ: No objection.

THE COURT: Admitted.

MR. GEORGE: Turning to page line—I'm sorry—43. Questions by Mr. George:

"What was the difference in the response between the test panels, Bullock Exhibit No. 1 and Exhibit No. 2?

"Answer: The difference is that on Exhibit 1 we did a two percent gross response, and on Exhibit No. 2, we did a 1.1 percent gross response, and in terms of net response on Exhibit 1, we did a 1.1 net response, and on Exhibit 2, we did a .9 percent net response.

"Question: I noticed on Exhibit 3 you have a different—the different decrease in response of 18.2 percent?

[sic] "That's correct.

"Question: Is that a significant decrease in response rate for packages that are identical except for the mention of sales tax?

"Answer: It's very significant."

MR. GEORGE: That's the (p. 289) end of the questions and answers I have out of this deposition.

THE COURT: All right. We'll recess then until 9 o'clock in the morning.

(At this time the proceedings were adjourned until 9:00 a.m. on February 4, 1986.)

Supreme Court, U.S.
FILED
JUN 7 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-1245

In The

Supreme Court of the United States

October Term, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

JOINT APPENDIX VOLUME II

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	)	
VS.	)	
	)	
STATE OF TEXAS, BOB	)	
BULLOCK, COMPTROLLER	)	JUDICIAL
OF PUBLIC ACCOUNTS OF	)	DISTRICT
THE STATE OF TEXAS,	)	
JIM MATTOX, ATTORNEY	)	
GENERAL OF THE STATE	)	
OF TEXAS, AND ANN	)	TRAVIS
RICHARDS, TREASURER OF	)	COUNTY,
THE STATE OF TEXAS	)	TEXAS

STATEMENT OF FACTS

VOLUME TWO

BEFORE THE HONORABLE JOE B. DIBRELL, JR.

APPEARANCES

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(p. 2) BE IT REMEMBERED, that on the 3rd, 4th and 5th days of February, A.D. 1986, the above numbered and entitled cause came on for hearing before the HONORABLE JOE B. DIBRELL, JR.

WHEREUPON the following evidence was given and proceedings were had, to-wit:

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(p. 5) (Before the commencement of the proceedings, instruments were marked as Plaintiff's Exhibits Nos. 49 and 50 for identification.)

RICHARD L. LEPERE

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please, sir?

A. Richard L. Lepere, 1607 New Hampshire Avenue Northwest, Washington D.C. 20009.

Q. Mr. Lepere, what's your business or occupation?

A. I'm an advisor to a number of publishing companies and financial institutions in the United States.

Q. Okay. Does your business include consulting with the management and publishers of magazines?

A. Primarily magazine publishers. I deal with them in a wide variety of areas (p. 6) including marketing analysis, marketing plans, financial analysis, evaluations, research, acquisition of divestitures.

Q. Can you tell the Court whether or not you perform consulting and advisory services regarding circulation programs?

A. I do indeed. That was my background—circulation and finance. It could range from developing a circulation plan for a new magazine to changing the strategy of a mature magazine.

Q. Could you tell the Court your professional background—what your work history has been?

A. Prior to forming my own firm in 1975, I worked for *U.S. News & World Report* as a marketing manager. I worked for *Psychology Today* as a circulation director, the latter being headquartered in Del Mar, California at the time, the—or excuse me—*U.S. News* being headquartered in Washington, *Psychology Today* being headquartered in Del Mar, California.

Q. Okay, and who are some of the companies that you perform work for currently in the magazine business?

A. The Washington Post Company, the (p. 7) owner of *Newsweek*, CBS, *The National Law Journal*—something familiar to you gentlemen—Morgan Stanley.

Q. What business—does CBS have a magazine business?

A. CBS has a half a billion dollar magazine division.

Q. What kind of magazines do they publish?

A. Oh, they publish *Woman's Day*. They publish *Road & Track*. They publish *Yachting*. They publish *Car & Driver*. They publish *Field & Stream* and a host of others. I just don't recall them off the top of my head.

Q. All right. What kind of work would you do for a banking company or a financial institution like Morgan Stanley?

A. My last asignment with Morgan Stanley was an acquisition analysis of the Law Journal Press, which is the publisher of *The New York Law Journal*, a daily newspaper, and *The National Law Journal*, a weekly newspaper covering the legal profession. It was acquired by Price Communications from Scott Foresman & Company,

and I was hired to determine whether (p. 8) the proposed price being offered for it was fair and reasonable to the buyers and if they could anticipate a reasonable rate of return on it.

Q. Did you—during the course of your business, are you familiar with and involved with the economics of valuing magazine properties for purchase or sale?

A. I do quite a bit of that.

Q. If you can, tell the Court the ones that you—transactions that have been concluded. What transactions have you been involved with that might be familiar to the Court?

A. I represented the group who were the underbidders in the *U.S. News & World Report* transaction.

Q. When was that?

A. Oh, that was in 1983, 1984. It was an acquisition that finally traded about a hundred and sixty-eight million dollars. I was involved in the acquisition of Law Journal Press, another client of mine, in December of '85. We closed the acquisition of *Mother Earth News*.

Q. In these transactions are part of your job the analysis of the magazine's (p. 9) operation and its valuing as a business?

A. That's correct. There are, however, other forms of evaluation. Many of my clients are privately held. We have to do evaluations for estate purposes, tax purposes, transfer of stock purposes to minors, and preparing market values of companies can take many, many forms.

Q. Okay. I have had the court reporter mark a list of your company's clients. Can you identify that, please?

A. Yes, sir.

Q. Is Plaintiff's Exhibit 50—is that a current list of the companies you've worked for and represented over the last few years?

A. Yes. It is not quite current. I could add a few more to it, if you like.

Q. If you know, can you tell the Court other companies that you've done work for?

A. Mutual Benefit Life Insurance Company is the most recent one.

Q. Is that in connection with the magazine industry?

A. Yes.

Q. What kind of work would you have done for them?

(p. 10) A. They are investigating the possibility of developing a communications division as part of their investment portfolio, and I have been retained to develop the list of possibilities for them.

Q. All right. Any others?

A. No, that's the major one.

Q. Okay. Now, in connection with your work—

MR. GEORGE: Well, first of all, I'll offer Exhibit 50.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. In connection with your work, have you had an occasion to become familiar with the method by which nationally circulated magazines or magazines generally are printed and the services to the subscribers—fulfillment services are rendered?

A. Yes, I have.

Q. Okay, and can you tell the Court what the circumstances are how you became familiar with that?

A. Well, for the past ten or 11 years I (p. 11) have been retained by 50 or 60 companies again to help them start new magazines, develop mature magazines. I have also been in the business of doing it myself. I am intimately familiar with the financial and operating problems of perhaps a hundred and fifty to 200 different magazines.

Q. Okay, and that's part of your regular business?

A. Yes.

Q. Okay. Now, can you tell the Court whether or not it is commonplace to have magazines printed in areas or places in which they're not marketed, such as *Texas Monthly* is printed in Tennessee and shipped down to Texas. Is that a common type transaction?

A. It's quite common. Printing and distribution is a function of really cost. There are a number of printers who have various configuration of presses, for instance, and *Time Magazine*, for instance, can't print its 4 million copies a week at one magazine—at one printer and ship it from one point because they wouldn't have enough time to close the magazine, get it printed, closing being wrap it up, have all of the stories in them. They wouldn't have

(p. 12) the time to close it and mail it and deliver it to customers on a reasonable timely basis. So they print at four or five printing locations across the country.

THE COURT: Well, are you saying—we may have an objection.

MR. MENDEZ: I've got an objection to his testifying about *Time Magazine* because I'm going through this list, and I don't see them on here as one of his clients.

THE COURT: *Time/Life Books.* I don't know, but that's maybe—

MR. MENDEZ: Well, I'd like to ask him before he goes on—

THE COURT: All right.

MR. MENDEZ: —is that how he found out this information before he goes on about that.

THE COURT: All right.

THE WITNESS: It's common practice. I'm familiar with it—

VOIR DIRE EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. How are you familiar with it, sir?

(p. 13) A. Because *U.S. News & World Report,* which is a client of mine, owns a company called Publisher's Service, Incorporated, which picks up all of the *Time* copy—copy for *Time Magazine* and transmits it to the various printers across the country. It's done electronically.

Q. And did you examine these records yourself, sir?

A. I was attempting to buy the company. I examined them very closely.

Q. Okay, and is that how you familiarized yourself with how *Time Magazine* might operate?

A. Yes, in addition to my general knowledge of how the business operates.

MR. MENDEZ: I'll withdraw my objection.

DIRECT EXAMINATION (Resumed)

QUESTIONS BY MR. GEORGE:

Q. Mr. Lepere, would you please continue to describe how *Time* would deliver its—

A. If *Time* upsets anybody, we can pick on *Newsweek* and *U.S. News & World Report,* which (p. 14) also deliver the copies of the magazine the same way. They will print at four or five or six, seven printing locations across the country, and the real reason is again it's a function of cost and timely delivery. They want to close their magazine and the story selection and put them into print at the latest possible date in the week, which is typically early Saturday morning. They want to print it and get it distributed so it's delivered in the majority by Monday, Tuesday of the following week, and that's just impossible to do trying to print in one location. So they will print in five or six. It is not an uncommon practice. *Newsweek,* of course, is located in New York City, and I don't believe they have a printer in New York City.

Q. Do you know whether any of those companies have printers in Texas?

A. I don't know that as fact. I don't believe so. I don't believe so.

Q. Now, do they—are you familiar with how they get the magazines that are printed around the country to post offices for placing in the postal services?

A. The postal rates for magazines is a (p. 15) somewhat complex procedure. There is what is called the single piece rate, which the post office charges for any magazine that enters the system, and then there's the per pound rate for editorial material, and they take the weight of the magazine and take the editorial material, and there's a rate for that regardless of where it goes in the country, and then there's another rate—per pound rate for advertising, which is zoned. For instance, if you're in Connecticut and you have a subscriber in California, it's being sent to zone eight, which is the most expensive zone—again the reason for the regional printing. *Newsweek* will print its West Coast subscriber copies most likely in Los Angeles to cut down on the postal rate for advertising poundage.

Q. Do they truck the magazines after printing to post offices—

A. Yes.

Q. —where they can be mailed?

A. Yes, or some of the larger printers have postal facilities right in their shop. The big R.R. Donnelley plants, the Krieger plants will have a postal facility as part of the (p. 16) printing production process.

Q. Okay, and from your knowledge of these—the big companies you've talked about, do they mail, for example, *Newsweek* and *Time* and *U.S. News & World Report*—

those kinds of companies mail their products all from New York?

A. No. No, it's simply impossible to do that.

Q. Do they mail them from all over the country?

A. They will mail them from—

THE COURT: Just a question. Do they have regional advertising, too, that's different?

THE WITNESS: Not necessarily. They all carry regional advertising editions, Your Honor, but it's more—for instance, the smaller—the big three news magazines—*U.S. News & World Report* would have fewer regional editions, and those regional editions would cover a larger territory than, for instance, *Time Magazine,* which has double the circulation and can make regions smaller for advertising purposes.

QUESTIONS BY MR. GEORGE:

(p. 17) Q. But it is true that *Time* would have advertising pages in a copy sent to Texas that it would not have in advertising pages sent to Utah?

A. That's true, but it's—again *Time Magazine* can have smaller regions because their circulation is four and a half million, where *U.S. News* would have a larger region because the circulation is two million.

Q. But each of them have regional editions?

A. Yes.

Q. Okay, and in terms of other magazines that are not in the *Newsweek* weekly kind of magazine that you

may be involved with, do they print them at one location, truck them to another and deliver them to the postal service, as well?

A. Again it's a function of printing press configuration—what kind of presses they have. There's *Architectual Digest* which—or Knapp Communications, which produces *Architectural Digest, Bon Appetit* and *Home Magazine. Architectural Digest* is 600,000 circulation. Knapp Communications is located in (p. 18) Los Angeles, but they print in Wisconsin. Okay, and they print in Wisconsin because it's a center section of the country, and so their postal rates are at its most modest point, and where they have big circulation going into a specific geographic area, such as Los Angeles, they will truck the copies to Los Angeles.

Q. And then mail them from there?

A. Mail them from the local L.A. entry point, as it's called, or they'll ship them to Atlanta, or they'll ship them to New York.

Q. All right. Now, in connection with—are you familiar with *Texas Monthly's* way of printing its magazine and getting it delivered to the postal service?

A. Generally, yes, I am.

Q. And you, I believe, were involved early on in the life of *Texas Monthly,* weren't you?

A. I was indeed.

Q. Can you tell the Court a little bit about your early involvement as a consultant with *Texas Monthly?*

A. I think I became involved with *Texas Monthly* in 19—late 1973 or 1974.

(p. 19) Q. That was the year it was—year after it began?

A. Yes. Yes, sir, when it was, as I finally referred to it, four guys sitting on orange crates trying to put out a magazine, and I assisted *Texas Monthly* in the development of their circulation planning and marketing, which in the early days was what was paying the bills. I guess the other area I became deeply involved in was just budgeting for the company.

Q. And your continued involvement lasted for—on a regular basis—

A. Eight.

Q. —for ten years or eight?

A. Eight, nine years.

Q. Now, and you're familiar today with—are you familiar today with the way the company operates generally?

A. Yes.

Q. Okay. Now, in connection with at least the physical system of printing and delivering magazines, does *Texas Monthly* in your opinion operate similarly to the other 50 or a hundred magazines that you've worked for?

MR. MENDEZ: I'm going to (p. 20) object before he answers that question because I want—I think that he's not qualified to answer that, at least as of the time I deposed him last week. He hasn't talked to these people for several years, except for about a two-minute conversation that he had last week, and I want to know how he became so familiar with today's—

THE COURT: You'll be able to bring that out on cross examination—the credibility of it. I don't see where it precludes his testimony.

MR. MENDEZ: It's going to. He's about to make an opinion about how they're operating today, and all I know is that he talked to them two minutes last week about what they're doing today.

THE COURT: All right. Well, I'm going to overrule the objection.

THE WITNESS: You know, I'm—as a practical matter, I have a number of friends at *Texas Monthly* who I consider personal friends, Mr. Gerhart being one of them, and from time to time we chat about any number of subjects, some very non-specific, some very specific, where I can be helpful, and while my (p. 21) day-to-day involvement with the company ceased about two years ago, I guess we've stayed in touch and just sort of idle chitchat. I know they're printing up in, I guess, Nashville. They're a very good printer. I presume it is a function of cost and delivery time.

QUESTIONS BY MR. GEORGE:

Q. Now, is their operation, as you're familiar with it, the same or substantially the same in mechanism, that is, the way it works, the way it's delivered, as other magazines that are delivered into Texas who are headquartered in Los Angeles or New York?

A. Sure. I'll use *Architectural Digest* as the example. They're headquartered in Los Angeles. They're printed in Wisconsin, and they're delivered to the State

of Texas, and my guess is, Jim; although, I can't tell you this positively, that they must have enough circulation in the State of Texas to truck it down here to make it worthwhile to truck it down.

Q. Okay, and that's commonly trucked into Texas for mailing to Texas of magazines such as this?

A. Sure. It's an entry point. I think (p. 22) Dallas is your main entry point in the State of Texas, if I remember my postal charts correctly.

Q. Okay. Now, can you tell the Court how magazines generally go about maintaining or building their circulation—the kinds of methods to acquire circulation that exists?

A. Well, you—you have this marvelous invention called direct mail or junk mail, as it's sometimes referred to, which tends to be the primary source for magazines. It tends to provide the greatest volume of orders for magazines. You then use space ads in other magazines, free-standing inserts in newspapers, agents—either direct mail agents, such as Publishers Clearinghouse, or American Family Publishers is the other large one.

Q. Those are the people that give away the 10 million dollars?

A. 10 million dollars, that's right.

Q. Ed McMahon gives away on TV?

A. That's right. It started out a long time ago with two houses or your dream house or something. It's escalated with inflation. They will—

Q. Do all publishers use those same (p. 23) kind of agents?

A. I beg your pardon?

Q. Do all of the publishers that you're familiar with use those essentially?

A. There are a very few publishers who don't. They tend to be the exception.

Q. All right, and you were mentioning—are there other kinds of agents—direct solicitation agents?

A. There are field agents. There's school agents. There's catalog agents. Field agents tend to sell door to door. School agents tend to be the children who go to their uncle two blocks away and say, "Please, Uncle Tom, buy a magazine subscription so we can get new football uniforms for the school." There are catalog agencies, which tend to sell to school districts—to libraries primarily. It's not students selling to parents or uncles. It's selling copies into the library itself.

Q. Now, in connection with these direct sales agents—the people who go door to door, either by school children or by otherwise—other kind of agents, such as people who claim to be working their way through college or other (p. 24) folks who come through to houses selling magazine subscriptions, do those agents take—solicit orders for the magazine?

A. Yes, they do.

Q. Is that the way they work? Can you explain to the Court how that system works, in terms of orders being

taken by these people and remitting them to the publisher and what happens?

A. Well, *Reader's Digest* is the owner of a company called Quality School plan, which tends to be the largest of what is referred to as the school agents. The fellow who used to be in charge of it—and I think he still is—is Bill Nielson. They organize regional—it's sort of like a pyramid. They organize regional people, their employees, to negotiate with the school systems, school districts or sometime individual schools to enter into an agreement where the school organizes the students to sell magazine subscriptions, and it's all the types of magazine subscriptions—not *Texas Monthly* or *Time* or *Newsweek*. I would imagine there's a hundred or so publications in there. They, in turn, arm the students with your little pamphlet and order forms. They go out and knock on doors. (p. 25) Be it their uncle or aunt or their dad or their mother, they sell the subscription. They collect the money. They turn it back over to the person at the school who organizes it, and they get shipped back ultimately to Reader's Digest Quality School Plan, who then disburses the orders out to the publishers.

Q. Now, are these people soliciting the orders for the publishers? They're not selling—they're not buying magazines and reselling them, are they?

A. No, they're not.

Q. Okay. They're soliciting orders?

A. Yes.

Q. Okay, and in your experience, you mentioned that you were—done work and involved with a hundred maga-

zines over your career in this country. Can you name any of them that—well, can you name some for the Court that use school plans? It may be easier ones that don't use school plans.

A. Yeah, mostly it would be easier that way. *The National Law Journal* does not use school plans. They—98 percent of them use the school plans. It's a very rare magazine (p. 26) that does not.

Q. Okay, and have you become familiar with the way that school plans operate through dealing with the school plans themselves?

A. In—when they first started, I think I was one of their first customers when I was at *U.S. World News & Report* as an employee, and yes, I became familiar with it.

Q. Okay. Are there other school plans, besides the *Readers' Digest* one?

A. *Reader's Digest* brought out one of the large ones, which was—I think it was called Sunland School Plans and there is now—TV Guide is the other major producer, and it brought out a—another service called Perfect Subscription School Plans, which used to be owned by Curtis Publishing.

Q. Okay. Now, in connection with the economics of these school agents—these people coming into—these representatives that are soliciting orders, do—who gets the majority of the money in those circumstances?

A. The Quality School Plan gets the majority of the money. The typical arrangement would be 15 or 20 cents on the dollar going to (p. 27) the publisher, the balance

going to Quality School Plan, who, in turn, has arrangements to pay various school districts and the schools so they can get their band uniforms or football uniforms or whatever the case may be that they're trying to acquire.

Q. Okay. Now, in connection with this sort of arrangement, why would a publisher pay out 80 to 90 percent of the total revenue from a subscription to a soliciting agent as commission?

A. For a number of reasons. One, of course, is to maintain your advertising rate base, which is the contract you have with advertisers to deliver a certain number of copies a month. The other and primary reason is for a publisher—while we tend to care what new orders cost us, we look at all of our other sources and try to do what's economically best, but our real money is—comes in from the renewal of that order, and if we can get—out of a hundred school orders coming in where we only collect ten or 15 or 20 percent of the revenue, when we renew them—45 or 50 of them—a year later, we keep it all.

Q. Okay, and the renewal is the price?

(p. 28) A. That's the price.

Q. Now, in connection with your work, have you become familiar with efforts by magazines over the years to try to collect in those—well, first of all, in those jurisdictions that have a sales tax or some other incremental fee, to collect taxes from subscribers through mail subscribers?

A. It's simply not done.

Q. Okay, and can you tell—have you seen some of your clients try to do it—operate in a way to see what happened?

A. There have been a number of things that have been tried, some not specifically related to sales tax but related to other things, and I can go back to the days where I was an employee for a company. I guess it was in the late '60s that a number of paper mills were destroyed in a hurricane, and the paper supply of the country shrank, and simultaneously there was an enormous announced rise in second class postal rates for magazines, and I don't know the exact statistics, but I think it was like a 500 percent increase to be phased in.

It was somewhat of a (p. 29) burden for publishers, and so we thought we would all be very clever and try to pass on those increased costs through selling the subscription and adding an amount for postage and handling. Well, the consumers weren't quite as dumb as we all anticipated, and we had our head handed to us, and the whole concept was dropped—not only by us but other people who had tried it.

We've had the case in the State of Maryland where similar circumstances have arisen in sales tax, and we have concluded that the cost of trying to collect the taxes is so enormous that we would rather pay it ourselves and not bother. It will undoubtedly be in litigation, but it just wasn't economically viable for us to try to collect the tax from the subscriber.

Q. Okay. Can you—are you familiar with various tests done by Texas publishers in response to this tax?

A. Yes, I am.

Q. Okay, and can you explain to the Court what the effect of—or how those tests operated, as you understand

them, and the effect (p. 30) they have on the decision to not attempt to directly collect the tax from the consumer who owes the tax?

A. Well, it—it's a—it's a pretty common phenomena that the higher the price the less people are going to order something. In the direct mail business that's particularly true. It's a very price sensitive business. I believe that tests for *Texas Monthly* specifically show a 17.3 drop-off in the number of people who respond when you put sales tax on versus not having the sales tax. I believe *D Magazine* had a test that looked like 18 percent, if I'm not mistaken, and I can't recall the number right now on the other magazine. It seems to me it was in the 20 percent range. I think three tests together all done on a scientific basis gives you adequate knowledge that you're going to experience a drop-off in results. The economic cost of that drop-off doesn't make trying to collect the tax or even to put it on there terribly worthwhile or economically viable for the publisher.

Q. Okay. Now, let's stop here and ask you assuming we've run a test and decided that (p. 31) it depresses their ability to get subscribers so much we're not going to try to collect the tax directly from the reader, then we're faced with the situation in which we'll—the Texas publisher is required to pay the—some amount of money to the State for this tax and chooses to pay in the 6.125 or the applicable percentage rate to the State, but it's faced with a world in which magazines mailed into the state are not paying the tax, okay? Let's make that assumption. Now, first of all, let's test that assumption. Are you familiar

with the practices of collecting taxes for your clients—the ones that—magazines you're working with?

A. I am indeed.

Q. Okay. Do they collect or pay taxes on Texas subscriptions?

A. No, they do not.

Q. And do they make an effort to try to get taxes or pay some sort of tax to the Texas Comptroller on Texas subscribers?

A. No, they do not.

Q. Now, in connection with the effort to determine—is it possible—let me ask you this way: Is it possible to determine what the (p. 32) Texas subscriptions are for national magazines—come up with a reliable estimate of how much money that's out there that could be taxed?

A. Yes, it is. The Audit Bureau of Circulation statements, which is an organization that audits magazine circulation, lists a—what is called a state count and breaks out the subscriber copies by state and U.S. possession of, I think, APO and FPO.

Q. Okay. Now, we've had some estimates in this case of how much tax Texas is collecting from Texas publishers and out of state publishers, and we've had two numbers, one—yesterday we had a revised number of about two and a half million dollars. Before that we had a number of one and a fourth million dollars, as I recall the testimony, and have you done some just kind of basic analysis of what four—just four companies that circulate in Texas—the revenue would be, if it was just those four companies?

A. This evolved out of—

MR. MENDEZ: Before he answers that, Your Honor, we may be getting into—and I'm not sure if Mr. George—if this may be (p. 33) one of the tax payers that is under the protective order, but if we might admonish him not to talk about—

THE COURT: All right. It will be Company A.

MR. GEORGE: He doesn't know that and—

THE COURT: All right. Why don't you explain it to him.

(At this time there was a brief discussion off the record.)

THE WITNESS: This whole discussion evolved out of some prior depositions where I had seen the figure of 1.4 million dollars in collected sales tax. I think at the time of the deposition I did a little quick mental arithmetic and concluded that it wasn't possible for the State of Texas to have collected the tax, because if you took any number of companies on their list, combined they would have paid some enormous amount of sales tax—not 1.4 million dollars. So I took—in that discussion that ensued with Mr. Mendez, I took four companies and did some quick arithmetic there, and then I went home and sort (p. 34) of organized it later, and the four companies, one being Company X, which is a big one, the Meredith Corporation, which is on, I believe, Mr. Mendez' list, the Hearst Corporation, which is on Mr. Mendez' list, and CBS—I looked at their total circulation that they have—their circulation in Texas. I looked at their subscriber circulation in Texas, and then you divide up the world in the two groups. You

divide up the world into—and this is from their Audit Bureau of Circulation statements—the number of copies that paid full price or basic price, as it's called, and the number of copies that were sold at less than basic price.

QUESTIONS BY MR. GEORGE:

Q. Now, what's—you're going to have to explain to the Court and to me the difference between basic price and full price.

A. Basic price is the normal rate they publish as the price of the magazine. For instance, if I use *Colonial Homes* as an example, their basic price is 24.97 a year for 12 issues. Their lower than basic price can be anywhere from 24.96 to 50 percent of that—I guess around $12.50. So we took the copies that were (p. 35) at the basic price, and in order to not get into an area of speculation, we took the lowest less than basic price they sold at. Understand that when they say less than basic price there's a number of prices they sell at that range up and down. We took the absolute lowest and applied that number to all of the other subscriptions, and we concluded using a—well, we concluded that there was some 54 million dollars worth of subscription revenues coming into the State of Texas based on these—

Q. Four companies?

A. —these four companies alone, and those four companies in themselves would have a tax bill of roughly $3,356,000.

Q. Okay, and based upon those calculations, as well as your own personal knowledge, you are confident that

tax isn't being paid by those companies—again the State's estimate of what they're collecting?

A. No, I will say that only one of these four are my clients. There are other clients on Mr. Mendez' list who —and other clients I know specifically who do not pay sales tax in the State of Texas or any other state.

(p. 36) Q. Okay. Do you have that calculation written up?

A. Yes, I do.

(At this time the instrument referred to was marked as Plaintiff's Exhibit No. 51 for identification.)

MR. MENDEZ: I'm going to object to the document on the basis that it was not made available to the defendants prior to the time of this trial and prior to the time the discovery ended. We have an interrogatory and request for identification of documents on file in this case that asks under the Rules of Civil Procedure that all documents that are going to be used in this trial be identified and made available to us prior to the trial, and on the basis of that discovery document and under the cases that apply to it, we don't think that this is an admissible document in this case.

MR. GEORGE: In response to that, the request for the production of the document or the calculations came from Mr. Mendez' examination of the witness on the 24th day of January, which I haven't looked that up, but Mr. Lepere came up with virtually the same (p. 37) conclusions in his head of the calculations at the time, which I'll have to look up the places. I don't think Mr. Mendez will dispute this.

MR. MENDEZ: Your Honor, I don't have an objection to what his testimony is. If he wants to talk about what he did off the top of his head, I'll ask him about that on cross. I'm just saying this exhibit is not admissible.

MR. GEORGE: And the document represents merely a summary of his testimony at this point in time, and the summary of testimony can come in, which he's already testified to.

THE COURT: The rule provides for summary. It's not a document study. It's a summary of testimony.

MR. MENDEZ: Well, Your Honor, I don't know what it is. I've never seen it before.

THE COURT: Well—

MR. GEORGE: He's testified to the facts on the document, and it comes in under the summary rule at this point because he's gone through the document itself (p. 38) and testified to the numbers.

THE COURT: Well, I won't consider the document as something independent, other than from his testimony if he wants to testify to—

MR. MENDEZ: Is it overruled then?

THE COURT: I don't want to—I don't want the ruling to be that the Court is not enforcing the rules with reference to discovery and requirements for submission of documents. If that is the case, then I will not consider it, but otherwise I'll tentatively let it in on the basis that it's on his summary of what his testimony will be here today.

MR. GEORGE: I have—rather than going over the actual numbers that he has done in—he has testified to the

bottom number on the pieces of paper already, and because of our protective order, it makes it somewhat awkward to go into the naming of the magazines and their circulation and the numbers that flow from it. If you'll note at the bottom of the page Company A, and this was a telescoping device. The point of the testimony (p. 39) obviously was they can't be collecting the tax, and he's already testified to that. I think Mr. Mendez certainly can't legitimately—can't claim surprise since the man did the calculations at his request.

MR. MENDEZ: Well, if I may, when was this document prepared, sir?

THE WITNESS: I'd have to look at my calendar and figure out where I was. I was down here for depositions on the 28th? 29?

MR. GEORGE: 25th, I think.

MR. MENDEZ: You were here last week, were you not, sir?

THE WITNESS: And I don't remember the exact dates right now, but I went back to Washington. I was in New York a couple of days. So it was mostly prepared last Thursday and Friday.

MR. MENDEZ: When did you come back to Austin?

THE WITNESS: Saturday evening.

MR. MENDEZ: Did you bring (p. 40) that with you?

THE WITNESS: Yes.

MR. MENDEZ: I still maintain my objection, Your Honor.

THE COURT: All right. I'll sustain the objection insofar as—on the document, but I still want to see it.

QUESTIONS BY MR. GEORGE:

Q. Okay. Now, Mr. Lepere, we've gotten—we're at a situation where we've got this proposition under analysis, whereby we have a company like *Texas Monthly*—*Texas Monthly* in particular, in which it has, because of its test results, decided it cannot collect the tax from its readers and must pay the tax out of its receipts, and it's faced in the world with many magazines in which it deals—competes with not collecting the tax. Can you determine as a result of your experience in making financial analyses of companies that have—and published magazines and appraising them and that sort of thing, determine what the amount of damage the company would suffer under those circumstances?

MR. MENDEZ: I'll object to that question because I don't think he has (p. 41) the basis to make the decision. He doesn't have the educational background, at least from the deposition that I did, to explain to us exactly what calculations he used. All we've heard is that he's been involved in some mergers or some evaluations, but I don't know what extent he's been involved in them, and I know from my deposition that he doesn't have an educational background that goes toward this financial analysis, and I'll object to his making any statement about their economic condition until I—you know, on that basis.

THE COURT: Overrule the objection.

MR. GEORGE: You can answer the question.

THE WITNESS: You'll have to go back and tell me what the question was. I'm sorry.

QUESTIONS BY MR. GEORGE:

Q. Okay. What I'm asking you to do—and we may be able to go through it, and you may be able to do it on the board or at your chair, but the analysis is assuming *Texas Monthly* is remitting the sales tax as out of its gross (p. 42) receipts and nobody else it competes with, from out of state at least, is doing so. It's taking money out of its income stream and remitting to the State and all of these other companies aren't.

MR. MENDEZ: I'll object to his question until he defines which out of state companies he's talking about with nexus or without nexus.

QUESTIONS BY MR. GEORGE:

Q. Well, let's limit it to the companies, for the purpose of this, that solicit—have people in Texas soliciting orders for their companies. That's—we'll limit those, and don't consider *The National Law Journal,* if they don't use Quality School Plans, but you can consider *Reader's Digest* and *Time* and *Newsweek* and *Cosmopolitan* and *Farm & Ranch Living* and all of these others, okay, and making those assumptions, just kind of walk the Court through how you would analyze the loss.

A. Well, Mr. George, there's a number of ways to view the question. Of course, if—if you take the position to just pay the tax—the gross receipts tax, you would look at the (p. 43) erosion of earnings, and that would be some amount—the tax—

Q. Assuming that the tax is—and we'll—we have an annual that we don't have a year's worth precisely of payments, but we're talking about roughly a hundred and

seventy-five thousand dollars a year paid to the State of Texas out of the earnings of this company. You've gone over the financial statements—

A. Yes.

Q. —of the company?

A. You then look at the way magazines are evaluated in this country, or any company, for that matter, has a value put on it. I tend to like to use the New York Stock Exchange listing as a fair and reasonable value.

Q. For magazine companies?

A. For magazine companies in particular, and you look at what those companies trade for in terms of their earnings. It's called a price earnings ratio. It is the amount of money that an investor is willing to pay for a share of that stock. As of January 7th, 1986 the PE value of—I picked five companies—selected companies, some of which are on Mr. Mendez' list (p. 44) and some which are not—

Q. What are the companies, by the way?

A. Dow Jones & Company, publishers for *The Wall Street Journal* and *Barons,* two heavily subscription oriented businesses, McGraw-Hill, publishers of *Business Week,* the Meredith Corporation.

Q. What do they publish?

A. They publish—

Q. Some of them are on your list, I think.

A. It's either—it's *Better Homes & Gardens,* I think. Yeah, *Better Homes & Gardens, Metropolitan Home* and

Successful Farming. They just acquired another magazine called *Ladies' Home Journal,* which is five million in circulation, which will be added to their list. I then took the New York Times Company, which has a large magazine division.

Q. What do they publish, by the way—publicize?

A. They publish *Cruising World*. They publish the alternative to *Woman's Day,* and I can't remember the name of it right off the top of my head. They publish *Golf*. They publish (p. 45) *Skiing* and a number of others.

Q. Okay. Any other companies on your list?

A. And Company X.

Q. Company X.

A. I'm sure I'm not allowed to name Company X.

Q. Okay.

A. The average PE ratio or the price earnings ratio, the price at which an investor is going to pay for a share of stock, was 17.8 times—

Q. Earnings?

A. —earnings, and if you calculate for *Texas Monthly,* you will have an erosion of earnings of approximately a hundred and seventy-five thousand dollars, which is the amount of proportionate tax. You place an economic loss of that of 3.1 million dollars. That is the value, as far as the New York Stock Exchange is concerned—the value of those earnings.

Q. Okay, and now, let me—in terms of a company such as *Texas Monthly* and the magazine business gen-

erally, what is the ratio of (p. 46) earnings ratio—the profit ratio in these companies? Do they make—are they talking about a ten percent return or five percent?

A. I think the average for 1984, which I believe is the last year statistics are available that are published by the Magazine Publisher's Association, was arou..l 11 percent in operating earnings.

Q. Okay. 11 percent return—

A. On sales.

Q. —on sales, and for—now, are you generally familiar with *Texas Monthly's* numbers? Would this be a significant decrease in its operating return?

A. It would be approximately ten percent.

Q. Ten percent reduction in its return? Now, in terms of long-term effect on a magazine in a competitive environment, can you tell the Court some of the impact such results would have, in terms of its competing with *Architect's Digest* for the reading time of people who want to read about the homes?

MR. MENDEZ: I will—is that question directed to one of those magazines— (p. 47) are we still working under the hypothetical that they're under that—in that catalog or something?

QUESTIONS BY MR. GEORGE:

Q. Let me pick one in the catalog. Let's pick something that is—*Harper's Bazaar* or *Gourmet* or *House Beautiful* or *Ladies' Home Journal* or *Money* magazine or *McCall's* or—those are—the New Yorker [sic]—some of the magazines. Assuming that those people are—have so-

liciting agents in Texas soliciting orders and they are competing for the time of the reader with *Texas Monthly* and they don't have this erosion to their earnings and they don't have this effect, what does that do to *Texas Monthly's* relative competitive position?

A. Well, in this case it's pretty straightforward. *Texas Monthly* has a hundred and seventy-five thousand dollars less a year to defend its market, and the converse of that is those folks have a hundred and seventy-five thousand dollar advantage in the State of Texas, if you isolated it to that geographic location.

Q. If you take this and expand the relative numbers so that we're looking at a (p. 48) magazine—for example, let's pick one that is not a Company X magazine but has a large circulation in Texas—*Newsweek*. About how many—do they have more circulation in Texas than *Texas Monthly* has?

A. This will be an estimate is all it will be. They have about 200,000 circulation, I would guess, in the State of Texas.

Q. They have about the same. Let's take Company Xs' largest magazine, all right, sir, and we have some numbers for it.

A. Okay. They would be about equal with *Texas Monthly*.

Q. Company X's would have—

A. Yes.

MR. MENDEZ: Could I see which one you're putting the—where is it? That one?

MR. GEORGE: Company X's largest magazine is number seven on the list of Company X's magazines, I think.

MR. MENDEZ: Okay.

QUESTIONS BY MR. GEORGE:

Q. They all are about the same number of circulation in Texas as *Texas Monthly*?

(p. 49) A. That's correct.

Q. And they are essentially sending the same number of copies to Texans as this company is and not paying a tax; is that—

A. That's correct.

Q. And so the damage to this company, as you calculate it, from doing what they are actually doing, which is paying it as a gross receipts, if valued today and they had to compensate themselves for it based upon these companies publicly traded is 3.1 million dollars; is that correct?

A. That's correct.

Q. Now, let's take it a step further. What is the value of price earnings ratios for privately traded companies you're familiar with? Now, let's—the ones that you've been involved in trades or know from your knowledge as a consultant in this industry—what have they been averaging? Give me some examples, if you would.

A. Mr. — if I could ask you a—I'm not clear on the question.

Q. Well, let's—these are all companies that are listed on the National Stock (p. 50) Exchange. I assume that—and some companies are purchased which are not—by non-public companies that are not public and are purchased for public companies, and you have a purchase price to deal with and you know the earnings of, and you believe *U.S. News & World Report* sold, that *The New Yorker* has sold in the last year, and you're familiar with those transactions, and you know what the price of the magazine in excess times—how much greater it was than the earnings they made?

A. I think you're referring to the premium paid for majority ownership.

Q. Yes.

A. When you buy a share of stock on the stock exchange, you're obviously buying minority ownership. There is a premium to be paid, ergo, all of the leverage buy-outs or takeovers. There's a premium paid for majority ownerships. In the publishing field in the past five years it has—it has—it has become a very dear commodity, I suppose is the best way to say it, and it's not only related to privately held companies. *U.S. News* was privately held, but there was a lot of public information on it. (p. 51) *The New Yorker,* for instance, was a publicly traded stock. I've done a little research into it, and I basically list this as premiums paid for mergers and acquisitions for publishing companies that have been taken over, and the companies are the Chilton Company, which was a major—

Q. How do you spell that?

A. C-h-i-l-t-o-n.

Q. And what do they publish?

A. They publish a bunch of trade magazines primarily.

Q. Okay.

A. But again it was one that was listed on the stock exchange, and you know, it's something we can all point to.

Q. And this is a premium for owning the whole company?

A. True. The price per share prior to the announcement was $26. The price per share paid for the company —a hundred percent ownership—was $86. It was an increase of 231 percent.

Q. Okay.

A. The—I'm not sure I can list this (p. 52) next one because it's part of Company X. It's a division of Company X.

Q. Division of—we'll call it division of Company X.

A. It was acquired by Company X in July of 1977. Its price per share prior to the announcement was $24. Its acquisition price was $30.

Q. And what was that?

A. It's an increase of 25 percent.

Q. 25 percent. Okay. Company X made a pretty good deal compared to Chilton?

A. Indeed. Wadsworth Publishing Company—

Q. What is Wadsworth?

A. Wadsworth is a—

Q. That's W-a—

A. —d-s-w-o-r-t-h. It was given a trade magazine publisher. Its price per share prior to the announcement was nine. It was acquired at a price of $31.50 or 250 percent premium.

Q. Okay.

A. Technical Publishing was acquired by Dunn & Bradstreet in August of 1977. The price (p. 53) per share prior to the announcement was $22.50. The price paid for the acquisition was $29.75 or a 32 percent increase in price.

Q. *U.S. News & World Report* was acquired in 1984. Its appraised price per share, which was public knowledge, was $625, and the purchaser paid $2900 a share for an increase of 364 percent, and the last one was a publicly figured firm, the New Yorker Company, Incorporated, publishers of *The New Yorker*. Its price per share prior to the announcement was a hundred and thirty dollars. Its acquistion price was $200 for an increase of 54 percent, and the average increase—the average premium paid for majority ownership was a hundred and ninety-one point two percent.

Q. So if you applied any of these numbers to this kind of earnings decrease, you would get a much larger number than 3.1 million dollars?

A. Yes, you would. You would come out closer to nine million dollars.

THE COURT: I assume we're not trying to collect this money from the State?

MR. GEORGE: No, we just (p. 54) want to be put back to even. Either they go collect it from all of these people, or they don't collect it from us, one or the other.

I would like to mark this as Plaintiff's Exhibit 52 and offer it into evidence.

(At this time the instrument referred to was marked as Plaintiff's Exhibit No. 52 for identification.)

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, Mr. Lepere, let's change the assumption. Let's change the assumption and assume that this company does not make the decision to pay it—the tax for its readers. Let's make the assumption that the company decides that the consumer owes the tax and we're going to collect it from that consumer and we're going to go out and do what's necessary to collect it. Despite the decrease in response to our direct mail packages, we're going to do a—an effort to collect the tax, as the tax statute is apparently written. Making that assumption, have you made any analysis of what the effect (p. 55) that court of action by the company would be on its value?

A. It would be—

MR. MENDEZ: I'll object to the question.

THE COURT: What is it, Counsel?

MR. MENDEZ: He hasn't been shown to have any experience about how to collect taxes, how corporations account for their taxes or how they attempt to get them from the individual subscribers, and he hasn't been shown to have any knowledge of how Texas applies its sales and use tax.

THE COURT: I'm not sure that's his question but—

MR. MENDEZ: He's being asked to give an estimate of the harm to *Texas Monthly*, if it has to go out and collect the taxes from the Texas users, and he doesn't know how the tax applies, or he hasn't been shown to know how the tax applies on it.

MR. GEORGE: Your Honor, when he has testified they've done these tests, they know the response rate fall off—

(p. 56) THE COURT: I assume we are getting back onto these test things that we had testimony on yesterday—

MR. MENDEZ: Yes, sir, but he—

THE COURT: —without objection. I had—all of this testimony came in yesterday with reference to you have a test mailing, and you have a—

MR. MENDEZ: Yes, sir, and I didn't have any objection to those persons because I think that that's valid to show that there's no harm, but what I'm saying is that this person doesn't know—that he didn't do those tests. We don't know what he knows about them.

THE COURT: All right. A few questions to see if he's familiar with the testing.

QUESTIONS BY MR. GEORGE:

Q. Are you familiar with the tests run by *D Magazine, Houston City* magazine and *Texas Monthly,* in connection with the attempts to collect the tax that you've read in the depositions and seen those?

(p. 57) A. Yes, I have. I am familiar with them.

Q. Now, going back to my question, my question is these—this company, *Texas Monthly,* does not make the decision to pay it itself. The company says, "Okay. I'm going to absorb that decrease in response rates and assuming by doing that I can get all of the taxes in and I'll pay them"—making that assumption, what happens if they absorb that decrease in response rates? Can you tell the Court the effect on the company that would have?

A. You would go through a similar exercise. You would look at a—an erosion of the earnings and you would—and I've attempted to do some calculations on that.

Q. Well, let's just kind of run through it quickly. You would have a decrease in your—assuming that we have—using *Texas Monthly's* response, which is the least adverse of them or the 17.2 percent decrease in response—we'll use that number. Okay. Now, what does that do to the company, and kind of run through the analysis for the Court?

A. Do we want to use the actual 1985 (p. 58) figures, or do you want to use the forecast in '86 figures?

Q. Well, why don't we use—why don't we use the actual—assuming '85 is repeated because we have actual numbers to work off of.

A. *Texas Monthly's* average subscription list in 1985 was 241,000 and change, and a loss of 17.3 percent would be a reduction of 41,700. No, any—

Q. Okay.

A. Pardon?

Q. Okay.

A. In here you have a number of areas to look at. Rather than pick on the ones that are subject to speculation and really would require a lot of detail, I stuck to just major ones. You would have a loss in subscription revenue of roughly $576,000.

Q. Now, that's a sub 566,000—

A. $576,000 in lost subscription revenue.

Q. All right.

A. Since advertising is sold on a basis of what's called cost per thousand readers—

Q. This is, a company with 200,000 (p. 59) readers charges less than a company for each page of advertising than the company with 240,000?

A. That's correct, but based on a cost per thousand basis, the lost advertising revenue would be approximately $2,072,000.

Q. All right.

A. There's a loss in what is referred to as ancillary revenue, which is the revenues of magazines derived from renting their lists from selling products to their subscribers, and on an average basis, that looks like $37,000.

We saw a little less than $1 in products to each subscriber to the *Texas Monthly* file.

Q. Now, this is—*Texas Monthly* would rent its list to *Newsweek* to solicit ads?

A. Yes.

Q. Solicit subscriptions?

A. Solicit subscriptions. They rent it to Book of the Month Club or rent it to Bloomingdales to sell whatever Bloomingdales wants to sell. Another area that's major is the lost revenue from insert cards out of the magazine—the little cards that tend to fall out and annoy most readers. Because your (p. 60) subscription lists will be down 41,000 copies, you'll have less of those cards. We calculate that to be about $43,000.

Q. All right.

A. Sum total of the lost revenue is about $2,727,000?

A. Two million seven hundred—

A. Twenty-seven.

Q. Okay.

A. And there are some savings that accrue in this to *Texas Monthly* also, which offset part of that. Obviously if they're producing 41,000 less copies, they've got $41,000 less the cost of printing the magazine, and based on their '85 costs, that is roughly $357,000.

Q. All right.

A. They've got a savings in distribution cost or postage costs primarily, because of sending 41,000 fewer magazines a month, of roughly $93,000.

Q. Anything else?

A. They've got a savings in advertising agency commissions, which is the commission—they sell an ad for a thousand dollars. The (p. 61) advertiser pays a thousand dollars to the agency. The agency keeps the commission and remits the rest to the publisher. That commission rate for *Texas Monthly* in 1985 was 14.22 percent. So they would save about $295,000 in advertising agency commissions. The net lost earnings—well, the total savings, Mr. George, would be about $744,000 approximately.

Q. Okay.

A. And the net change in earnings or net erosion of earnings would be approximately $1,984,000.

Q. 1,984,000, okay, and that's earnings decrease?

A. That's an earnings decrease, earnings erosion. I'm afraid neither you—neither you nor Mr. Mendez really—really understand that that is—that is a—that is a straight line, strictly arithmetic problem over there. There's a whole set of other problems that occur when you decrease your rate base. The advertising community is not going to look very fondly on that. Your competitors—*Texas Monthly's* competitors are going to look at a reduction in *Texas Monthly's* circulation as a (p. 62) major sign of weakness, and indeed I would anticipate the erosion in advertising to be far greater and—

Q. When the regional—the guy who's selling ads for *Time*—I'm sorry—for *Newsweek* or some other company in Texas to—RepublicBanks run ads in national magazines, and he comes in and wants to sell ads for that magazine. He would be competing with *Texas Monthly?*

A. Correct.

Q. For selling ads to the same bank chain?

A. That's correct.

Q. And he would be able to go and say, "Mr. Bank Advertising Director, this magazine is losing subscribers, and they must not be doing very good. So don't trade with them, even though their price per page is lower because they're going down, and we're going up"?

A. That's correct.

Q. But you haven't included that because you don't know how to quantify it?

A. It's quantifiable, but I don't believe it will ever happen because I don't (p. 63) think *Texas Monthly* could withstand the onslaught of competition at that point, and they would—they would elect to pay the tax themselves. Doing that would be like rearranging the deck chairs on the Titanic. It would just be impossible.

Q. The company would essentially not be able to continue to be viable?

A. I would dare say *Texas Monthly* would be out of business in two years. I don't think they could survive that kind of reduction.

Q. And if you take that $1,984,000 and apply these capitalization rates that you get, you'd get a loss number of—

A. It becomes an extraordinary number on the asset, and that's really what you're dealing with is a value of that asset. You know magazines—magazines don't have

any hard assets. They don't have any trucks, and they don't have printing plants. They've got a name and a reputation period, and they've got a printed page they put out every month, unlike a newspaper or broadcast organization. That asset can depreciate very quickly and be a memory.

MR. GEORGE: Before I (p. 64) forget I need to mark and offer this as Exhibit 53.

(At this time an instrument was marked as Plaintiff's Exhibit No. 53 for identification.)

THE COURT: Any objection?

MR. MENDEZ: Can we withhold on the admission of this until I've had an opportunity to cross examine him on it?

MR. GEORGE: No, I object to that procedure. Either it's in or out, and he can question it on the weight of it, if he wants to.

THE COURT: What's your objection? Do you have an objection?

MR. MENDEZ: I'm not sure how he arrived at that number up there—17.2, and I'm not sure whether, from what—from the direct examination here, what relevance that has to these calculations as to—

THE COURT: I know but what's your objection? You're stating what you don't understand, but what's your objection?

MR. MENDEZ: I think it's inadmissible hearsay, or it's based on (p. 65) inadmissible hearsay, and I want to

know what he used to arrive at them before I object or don't object to that.

THE COURT: I'll overrule the objection.

MR. GEORGE: Now, with that I will pass the witness.

MR. MENDEZ: May I have about five minutes to organize my cross examination so that we can—

THE COURT: We'll take a 15-minute recess.

MR. MENDEZ: Thank you.

(At this time a brief recess was taken, after which time the proceedings continued as follows:)

CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Lepere, we've met before; right?

A. Yes, we have.

Q. Okay. We had a deposition last week on this case; right?

A. Yes, sir, we have.

Q. And we discussed—at that time you (p. 66) didn't have an opinion about the economic effect on this corporation; is that correct?

A. Mr. Mendez, I had obviously a general opinion. I didn't have the details of it, and rather than confuse the issue with a lot of speculation, I thought it would be best to just do the fundamental arithmetic of the problem.

Q. Okay, sir, and but you didn't have a number or a calculation of what number was the effect on *Texas*

Monthly as a result of its having to collect a tax; is that correct?

A. I think like the—

Q. Sir, I'm just asking you if that's a correct statement or not. Is it a yes or no answer?

A. Well, it's not quite a yes or no answer.

Q. Okay. Well, go ahead.

A. Like the problem of what other companies should be paying a sales tax, I tried to do some rough arithmetic for you at the table. As I recall you asked me specifically how I was going to arrive at the number, since I didn't have one, and I outlined the general (p. 67) framework of it.

Q. Okay, sir, and did you give me a methodology of how you would arrive at those numbers?

A. I gave you a rough knee-jerk methodology at the time.

Q. Okay, sir. Well, I want to make sure before you go on that did you change that methodology after you left that deposition and actually did these numbers that you're testifying here today? Did you change the methodology from what you told me you were going to use?

A. Very slightly.

Q. Okay. What did you change?

A. In the—in general what I've done is, rather than getting into issues of losses and earnings and additional costs that were detailed and subject to speculation, I eliminated that. I just threw them out—the same thing in what

magazines should be paying in sales tax. Instead of trying to calculate all of the subscription prices paid, I used the absolute lowest number. In the case of these actual costs, I think one of the items I had (p. 68) outlined in the methodology was the cost of administering the tax. There is a cost associated with it. There's additional fulfillment charges. There's additional cost of materials. There's trying to get a fulfillment house, which is the places that process orders in open mail to change their programs to carry these records. At this point in time the one I spoke to said they could not do it.

Q. Okay, sir.

A. And I threw things like that just out. I didn't include them in the calculations.

Q. And you don't think they're valid in your calculation; is that correct?

A. They're valid, but I think we could spend the next two weeks discussing each individual item.

Q. Well, sir, would they make this estimate more accurate?

A. They would make the estimate of economic loss higher.

Q. Would they make it more accurate?

A. No. I mean, it's within five or ten percent right now.

Q. Well, that's what I'm asking you. (p. 69) Would it make it more accurate?

A. Sure. In that sense it would make it more accurate.

Q. And it's your testimony that you did this estimate using the methodology that you did because of the time constraint that you were under; is that correct?

A. No, that is not correct. I did it because I did not want to involve the State or the Court in lengthy discussions of the cost of adding trailer records to fulfillment files at a fulfillment house in Iowa.

Q. Well, sir, if that lent to the accuracy of the number that we're trying to figure out and if that's the issue before this Court as to what that number is and to the best, most calculable stage that it can get at, then why don't you think that it's relevant for this Court to hear it or to have it as part of this estimate that you've prepared?

A. Mr. Mendez, it's the difference between getting a cost of building a house based on lumber, nails, blueprints, kitchen equipment and doing an estimate on a house based on the number of man hours it takes to cut two by fours (p. 70) up. It's just—it's just incredible detail.

Q. Okay, sir, but it is your testimony that that would make this number correct or more accurate; is that correct?

A. It would make it more accurate. It would inflate the number, and I didn't feel that it was that necessary.

Q. Okay, sir. Now, I want to go back—before we go into this case, I want to go back. What is your educational background? Could you explain that to the Court, please?

A. I graduated from high school. I have about 60 credit hours college from the University of Virginia from the Northern Virginia campus.

Q. Do you have any other educational experiences?

A. Attending trade seminars and whatnot but not on a formal basis.

Q. While you were at that university, did you study economics?

A. Yes.

Q. What courses in economics did you have?

A. Economics 101, 102 and 103.

(p. 71) Q. And did you study anything about finance?

A. Yes, I did.

Q. What courses in finance do you have?

A. Accounting, purchasing materials and management, math, and then there were some other courses but I can't—

Q. You have 60 hours; is that correct?

A. Roughly 60 hours.

Q. That's approximately two years' worth of college?

A. Yes.

Q. Okay, sir, and you're involved here—it says on your resume, which is an exhibit in this case, that you're involved in consulting with a list of clients that you've written here and that you're involved in making decisions as to their management, their marketing, their circulation programs, their finance, their investment analysis, their

acquisitions and divestitures, their appraisals. Are those things that you do for them?

A. Yes, they are.

Q. Okay, and what other educational background do you have, with respect to (p. 72) economics or finance or accounting that go to this—and what I'm asking is I'm asking about formal training that go to these types of consultations?

A. Mr. Mendez, there are no formal classes—there are now, but when I was getting out of high school and coming into the work force there were no formal classes in, quote, magazine management. There are very few today. Most journalism schools taught journalism, writing. I went to school at night carrying about nine credit hours a semester. By the time I completed whatever I was completing, I was already in the work force for—

Q. Okay, sir.

A. —four or five years and picked up much of my experience in just on-the-job training.

Q. Okay, sir. Could you explain for the Court what experience you have with respect to acquisitions and divestitures, and in particular, could you explain for the Court what you did with respect to the merger of or acquisition of Morgan Stanley Corporation?

A. I only wish I could acquire Morgan (p. 73) Stanley. Morgan Stanley is a major—it's a premier investment banking house started by J. P. Morgan. Morgan Stanley requested my assistance on behalf of one of their clients, Price Communications, in the acquisition of a company

called Law Journal Publishing Company, which are the publishers of *The New York Law Journal,* a daily newspaper for the courts and lawyers, and *The National Law Journal,* a weekly newspaper for the legal community, but it was not the acquisition of Morgan Stanley.

Q. Okay, sir. Well, you say that you were involved in the acquisition for *U.S. News & World Report.* What did you do for them?

A. I'm not sure which question you want me to answer. Do you want me to answer the first one or the second one?

Q. Well, was there an acquisition that you were involved in that involved the company, *U.S. News & World Report?*

A. Yes, there was.

Q. And what did you do for them?

A. I led a group that sought to acquire the company, and I was an equity participant in that.

(p. 74) Q. What's an equity participant?

A. I would be an owner of the business.

Q. What did you do to decide or not to buy this company or to become—to become an owner of this company?

A. Well, we—when the documents were made available—their historical records—we analyzed the business. We analyzed how we would improve the business. We analyzed where we thought the market was going for the magazine and what its opportunities were in the future, and we made a conclusion on what we felt we could pay for the business.

Q. Who was involved in this team of persons that you worked with?

A. Myself, the communications lending group, Bank of Montreal, Citicorp Capital Investors, which is Citicorp's venture capital arm, if you will. They're in business to fund—fund entrepreneurs basically and a host of lawyers, accountants, whatnot.

Q. Okay, sir, and what kinds of documents did they give you?

A. What kind of documents did who give me?

(p. 75) Q. Well, the company that you were looking to acquire. What kind of records or historical documents did you get from them?

A. Jesus, just about anything you asked for—obviously all of their financial data—historical financial data.

Q. Well, what was your role—your specific role in analyzing those records?

A. My role was to evaluate that information, to make an assessment of how the business could be improved, if it could be improved, if it had a future that would justify a given acquisition price.

Q. And how did you analyze the specific price for that company?

A. I—we analyzed what we felt the company could produce in earnings in the future. We looked at what we thought we could pay for it as a maximum, and did it provide a decent rate of return for the investors.

Q. Well, you keep saying we, and I keep saying, well, what you did. What I'm trying to get at is what function—what job title or what thing did you do with respect to that analysis? If you had accountants that actually (p. 76) looked at the financial records or if you had lawyers that looked at the underlying transaction or the contract, well, say that, but what I'm asking is what was your role?

A. Mr. Mendez, I am not a lawyer. So I am not equipped to read a long contract with a printer and really discover the ins and outs of that contract. I can look at the printing contract and make a judgment whether it's a good contract, whether you can get a better price elsewhere. I can ask a lawyer to say—to tell me, upon reviewing it, "Gee, if I can get a better contract elsewhere and improve the business, what is my obligation to this printer?" He has got to tell me that. I'm obviously not equipped to do it. My role was to analyze those numbers as best I could and to make an assessment of what the business—how the business would perform in the future given certain circumstances and what a reasonable price was we could pay for it—that obviously and the subject of the review of the lending institutions, which they looked at very hard.

Q. Okay, sir, and what kind of tools do you use to make this analysis of what they're (p. 77) going to do in the future?

A. They are judgments based on my experience in where the market is going. I can't predict for you that the economy is going to be up 20 percent next year. I can make a guess at what its going to be, but no one knows.

Q. Well, is this a guess based on just, you know, plucking a number out of the air or do you—

A. Not at all.

Q. Well, where do you get it?

A. You get it from fundamental experience and the—in the specific case of magazines, for instance, we felt that personal financial advertising would be on the rise in the next two to three years, and we had determined that a minor shift in editorial focus would allow us to attract that advertising more so than they had to date. That's the type of assessment one has to make, and it's a judgment call.

Q. So you—your testimony is that at least with regard to mergers and acquisitions and at least with regard to this *U.S. World & News Report* merger—

(p. 78) A. It's *U.S. News & World Report*.

Q. —your job was to give a judgment call, as to what you thought that business was going to be worth?

A. It was my place to determine how the business would perform and what we could reasonably pay for it, given the rates of returns that were expected from the investors.

Q. Okay, sir. You mentioned that you've done tax analysis or evaluations for tax purposes before. Could you give us an example of a company that you've done a tax analysis for?

A. I have to ask a different question, if I may?

Q. Sure.

A. Your Honor, some of this is very privileged and private information. They're privately held companies and it's not—

THE COURT: We can give some designations. I don't—it doesn't make any—

QUESTIONS BY MR. MENDEZ:

Q. Sir, you don't have to tell me what the name of the company was. If you'll tell me what state it was in and what the circumstances (p. 79) were so that I could get an idea of what you're talking about, that's fine with me. What I'm trying to get an idea of is what type of transaction were you looking at, and what did you do with it?

A. A case in California, a privately-held company publishes four consumer magazines. The owner is roughly 50. Question of how you disperse stock to the children, and I'm not a tax lawyer, but the question of valuations arise in order to distribute that stock, and my job was to place a valuation on the company at the date that some stock was given to the children.

Q. Okay, sir, and did you do this on your own or with a team?

A. On my own.

Q. Okay, and what records did you require from the corporation to do that?

A. Their financial records and their historical operating statistics.

Q. Okay, sir, and what tools did you use to analyze those records to arrive at a value?

A. Literal tools?

(p. 80) Q. Well, sir, what I'm asking is what concepts—what economic or financial or accounting concepts

did you use to arrive at a number which you used for tax analysis purposes?

A. I don't have to deal with accounting concepts because they prepare their records in what is referred to as GAAP, Generally Accepted Accounting Principles, and it's audited by the big eight accounting firms. So I don't have to deal with it. I have to deal with the underlying assets of the business and the value of the magazines.

Q. Okay, sir.

A. And it's earning—obviously it's earning power. If you take the strict Internal Revenue Service definition of that, I think they look at the earning capacity of the business, the dividend capacity of the business, and there's six or seven points that are looked at, but I just can't rattle them off.

Q. I guess what I'm trying to get—of course, I'm not trying to harass you. All I'm trying to find out is how you go about doing your job. Did you give them a number that said, "Yes, at the date of transfer this is how much (p. 81) these number of shares were worth"?

A. I gave them an analysis that said, "At the date of transfer this is what the fair market value of a share of stock in this company is."

Q. And that was your opinion?

A. Yes.

Q. And how did you get from the data they gave you to there?

A. Not too dissimilar from what we've done here. People have a way of valuing things that I sort of describe

as bordering on voodoo. Obviously the value of something is the price at which something will trade hands between a willing buyer and a willing seller. I think the phrase is neither under compulsion to buy or sell and both having reasonable knowledge of all of the facts. That's all I'm attempting to get at in this case is what is a fair market value. Today if you sold a minority interest in the company, what would it trade at? So I tend to look—instead of dreaming up things, which is easy to do to prove a point, I tend to look at public records where you can point to something and say, "Here is a similar company that's in a (p. 82) similar business, and here's what it sells for."

Q. Okay, sir. Do you look at their GAAP financial statements? Do you look at their Generally Accepted Accounting Principles financial statements?

A. Yes.

Q. Did that company have some?

A. Yes.

Q. Okay. When you're going—do you look at their balance sheet?

A. Yes.

Q. Okay. When you're looking through the balance sheet, do you take out the deferred credits that are listed on there and not classify them as assets?

A. There are a number of ratios you look at. You look at the current ratios. You look at debt to equity ratios.

Q. Well, how did you calculate the debt to equity ratio in a corporation?

A. You know, the current debt to equity ratio? Long-term debt to equity ratio?

Q. The current.

A. The current is very simple. You look at their short-term debt. It's called a (p. 83) quick ratio—their short-term debt and liabilities compared to their cash, accounts receivable, liquid assets, if you will, and that's your current ratio.

Q. Okay, sir, and how would you do it on a long-term basis?

A. It's essentially the same number. It is a—but just taking the long-term portion of that including plant, equipment, long-term assets on the balance sheet credit side.

Q. Okay, sir. Do you have any experience with regard to the—with any sales tax of any state other than the State of Maryland?

A. District of Columbia where I live. I pay sales tax there.

Q. Have you done any consultation work for any one of these many clients that you've listed in your resume regarding their sales or use tax?

A. Only *Baltimore Magazine*.

Q. And isn't it true that in the *Baltimore Magazine* situation they did an analysis of whether or not to solicit the sales or use tax from their customers and then (p. 84) eventually decided not to do that?

A. That's correct. We—I'm an advisor to them, and we made the judgment to go ahead and pay the tax and

argue about it later, rather than taking the decrease in response from our subscribers.

Q. Sure. Now, sir, do you know if—when did you do that analysis?

A. I think we added the tax about a year ago. So the analysis was done subsequent to that or prior to that point.

Q. Okay, sir, and do you know if there is still a tax applicable to the *Baltimore Magazine* in Maryland?

A. Well, we are paying a sales tax, if that's what you mean. We just included it in the price. We would sell a subscription for $7.95 instead of adding—and I think the tax ratio is five or six percent. I'm not positive. Instead of adding five or six percent to it, we just included it as part of the 7.95 pricing. We pay it ourselves as gross receipts tax basically.

Q. Is the company still operating?

A. Yes, it is.

(p. 85) Q. Okay. How long has that company been in operation?

A. It's been in operation for at least 70 years. It was purchased by its most recent owners—it was a magazine published by the Chamber of Commerce up until either 1976 or 1977 when my clients subsequently bought it.

Q. Was that a situation where they became subject to use tax or sales tax, or was there a raise—an increase in taxes all of a sudden?

A. It was a case where the State of Maryland decided that they should be included in sales tax, and I guess

it was an expanding of the definition of what—what is under sales tax.

Q. Okay, sir. Now, I want to get into some testimony that you gave about *Architectural Digest*, a publication that you say you're familiar with; is that correct?

A. Correct.

Q. Okay, and they're a client of yours, aren't they?

A. Yes, it's published by Knapp Communications Corporation.

(p. 86) Q. Do you know if it pays the Texas sales and use tax?

A. I don't believe they do.

Q. Okay, and when was the last time you talked to them?

A. Two weeks ago.

Q. Okay, sir, and they didn't mention anything about Texas sales or use tax?

A. No, there would be no reason for us to talk about it.

Q. Do you know if they have an office in Texas of any sort?

A. They don't have an office in Texas.

Q. Do you know if they have a warehouse in Texas?

A. I don't believe so.

Q. Okay. Are they listed in any one of those *TV Guide* or Quality School Plan exhibits?

A. I'm sure at least one, if not all three or four of the magazines are. If you would like me to check, I will.

Q. No, that's fine, but to the best of your understanding, they're listed in that?

A. Yes.

Q. And they're not remitting sales or (p. 87) use tax to the best of your knowledge?

A. That's correct.

Q. Do you know if X Company has any offices in the State of Texas?

A. I'm almost positive they have an advertising sales office in Texas.

Q. What city is it in?

A. I believe it's in Dallas.

Q. Okay, and would you have a document or something that you could look at to find out if they do?

A. I could look at their advertising rate card, or I suspect it's listed in a publication called Standard Rate and Data.

MR. MENDEZ: If I may, Your Honor, may I approach—

QUESTIONS BY MR. MENDEZ:

Q. I'll hand you what has previously been marked as Defendants' Exhibit No. 1. Can you identify that document?

A. It's an Audit Bureau of Circulation Magazine Publisher's Statement. It is an estimate of what their paid

circulation is subject to an audit by the Audit Bureau of Circulation.

(p. 88) Q. And you're familiar with those documents?

A. Yes.

Q. And you use them in your work, don't you?

A. Yes, I do.

Q. Is there any place on there—is there any function of the Audit Bureau of Circulation that requires the listing of any offices or contacts that a company might have in each particular state?

A. No, it does not. It's just their—what they call their home office or publishing office.

Q. Sir, there's a—you mentioned a magazine called—or a company called Meredith?

A. Yes.

Q. I'm not familiar with what publications it puts out. Could you explain to us what they publish?

A. Meredith publishes—well, they just acquired *Ladies' Home Journal* recently, and Your Honor, if I may borrow that list?

MR. GEORGE: Here is a—this one?

(p. 89) THE WITNESS: They publish *Better Homes & Gardens*, a magazine called *Metropolitan Home*, which formerly was called *Apartment Life*, and they publish *Successful Farming*.

QUESTIONS BY MR. MENDEZ:

Q. Okay, sir. Do you know if that corporation maintains an office in the State of Texas?

A. No, I do not.

Q. And how about a warehouse?

A. No, I do not.

Q. For CBS and Hearst, which you also mentioned as having circulation in the State of Texas and compared in certain analysis in your testimony, do you know if those two companies maintain offices in the State of Texas?

A. No, they do not.

Q. Okay, sir.

A. I do know they sell advertising in the State of Texas, and they certainly sell subscriptions.

Q. You mentioned that you'd done a calculation—you were testifying to the Court that you had done a calculation of how much tax (p. 90) X Company should have remitted to the State of Texas. What number did you come up with for a year?

A. 2.065 million dollars.

Q. Okay, sir, and do you know what rate X Company remits—

A. I beg your pardon?

Q. Do you know what rate X Company remits or reports its Texas sales and use tax at?

A. No, I think the discussion we were having at that time was about whether indeed you could have collected taxes from these folks.

Q. Well, what rate did you use to arrive at your—

A. I used 6.12 percent.

Q. Okay, sir, and with respect to X Company, what deductions did you make from their total circulation on their ABC report to arrive at Texas taxable sales.

A. I'm sorry?

Q. What deductions did you make from their gross receipts from Texas business to arrive at their taxable receipts in Texas business?

A. I took what their circulation was (p. 91) and the number of copies they put into the state based on their own statements times their stated prices to provide a value of subscription copies coming into the state based on their data and publicly known data and applied a 6.12 percent tax rate to them.

Q. Do you know if there are any applicable deductions to that?

A. No.

Q. Are you familiar with the Texas Sales and Use Tax Act?

A. No, I'm not.

Q. So you just took a gross number and multiplied it by that tax rate?

A. That's correct.

Q. And if there are deductions at that company—are you privy to X Corporation's—X Inc.'s records?

A. No, I'm not.

Q. Are they one of your clients?

A. No, they're not.

Q. Okay, and would you know if they might have had other—

A. Let me—a division of theirs is one of my clients, but it was not a magazine (p. 92) division. It was a book division.

Q. Okay, and with respect to the magazine publishing divisions, would you know what they might have reported in terms of tax?

A. No, I would not.

Q. Do you know or did you take into consideration the fact that they might have paid tax in another state, and that would have applied as a deduction to the Texas tax?

A. Similarly my answer is no, I did not, but I only know of two states that indeed comport to what you're proposing.

Q. Okay. Which states are that?

A. That's you and the State of Maryland.

Q. Well, are you familiar with the fact that certain states other—I mean, and not just those two but that other states require the shippers of goods to pay the sales tax in their home state, regardless of where the ultimate destination of that product is going?

A. I know of no such thing like that in the magazine business, which is the only real business I can speak to.

Q. But I'm asking about taxes in general and about the administration of State (p. 93) sales and use taxes, and I'm asking you, from your knowledge of those, are you familiar with that concept?

A. No, I'm not—

Q. So if they're—

A. —but I'm not a tax expert either.

Q. Okay, sir, and you mentioned that you'd calculated tax for several other companies or a possible tax. Did you do it in the same way?

A. Yes, I did.

Q. Okay.

THE COURT: Do you need a drink of water?

THE WITNESS: No, no, I'm fine. Thank you.

QUESTIONS BY MR. MENDEZ:

Q. I'd like to turn now, sir, to your estimates over here that you've come up with, Plaintiff's Exhibits 52 and 53. You've picked, it seems like, five companies over there to use, and is it fair to say that you're using those because they have a publication that has similar circulation in Texas to *Texas Monthly?* Is that why you picked those?

(p. 94) A. No, I picked them in part because they're in the magazine subscription business, or in the case of *The Wall Street Journal*, heavily into the magazine subscription business. It's a newspaper obviously. I picked

some of them in part because they were on your list of the State of Texas—whatever that list was you gave me at the deposition, and I picked them partly because they're publicly traded, and we don't have to speculate on what the market value of their stock is or their earnings are—that it's recorded in the paper every day.

Q. And they've got generally accepted accounting—they have GAAP financials?

A. But by being on the stock exchange, they are required to.

Q. Okay. Did you calculate their price earnings ratio?

A. Yes. Well, I didn't—in fact, I just took it out of the paper as is published.

Q. Okay. As of January 7th?

A. As of January 7th.

Q. Do you know what period of time is used in the calculation of that January 7th price earnings ratio?

(p. 95) A. It is the earnings they paid in the preceding year.

Q. What are the accounting years for those corporations?

A. I would have to look them up. I can't tell you specifically.

Q. Would they relate specifically to the accounting period that you used for *Texas Monthly*?

A. Not necessarily, but it's an annualized—it's an annualized number. So I'm not sure it's real—really necessary.

Q. Well, what's a price earnings ratio?

A. Price earnings ratio is the price of the stock that's trading on any given day divided by the earnings of the company in the last—in the preceding year.

Q. So if the price of the stock changes one day, then the price earnings ratio changes?

A. That's correct.

Q. So if the price of one of those stocks had been $2 less the day before January 7th, then its price earnings ratio would have been some other number; is that correct?

A. That's correct.

(p. 96) Q. And did you go back and figure their price earnings ratio, let's say, a year ago?

A. No.

Q. Okay, and did you project a possible price earnings ratio for those companies for future years?

A. No.

Q. Okay. So this is just a static picture of their price earnings ratio at one period of time?

A. Yeah, it's a—you know, again, Mr. Mendez, I don't like to get into the voodoo of what something is worth. I try to look for a record that is clear and understandable and its consistent, and, yes, if the stock market collapses, the PE ratio of Dow Jones is going to plummet, and if the stock market goes up another 400 points, the PE ratio of Dow Jones Company is going to rise.

Q. Well, sir, I'm just—

A. I have a *Wall Street Journal* in my brief case. I'm sure those PE ratios changed from January 7th to today, and I'll be glad to look them up.

Q. I'm not trying to harass you, sir. (p. 97) All I'm trying to—I don't know anything about finance. I'm asking for you to explain to me what the relevance of this 17.8 number is, and what I'm asking—it seems to me that if it changes every day then the fact that it was 17.8 as an average for these companies on that January 7th—it doesn't mean anything because it could have been 5.1 the day before or—

A. No, no, no. Wait. I beg your pardon. It would not be 5.1. There would have to be a crash in the stock market akin to 1929 for that to occur, or they would have to discover that Dow Jones Company had misreported its earnings by some staggering amount for some period of time in the past, and that is just an incredibly unlikely scenario.

Q. Okay, sir. So that's why you're using this 17.8 number; is that correct?

A. I'm using it because I don't want to involve the Court in a lot of speculation. I don't want to waste the Court's time with it, and I'm looking for a number that's fairly consistent over a long period of time that's reported daily in public records that you can point to—that anybody in this courtroom can (p. 98) point to and say, "That's what an investor values a share of stock in Dow Jones at."

Q. Okay, sir. What's the total net worth of Dow Jones?

A. I would have to go get their annual report and tell you, but this isn't valuing their net worth. This is valuing their earnings.

Q. Okay. What are the total earnings for a year for that corporation?

A. They're enormous, but whether it's a dollar of earnings or a hundred million dollars of earnings, it's still being valued.

Q. And on what basis?

A. By what the market believes—and we're all part of the market—the value of that company is.

Q. Okay, sir, and there's a general market, the New York Stock Exchange, that all of these persons trade on; is that correct?

A. Well, one trades on the American Stock Exchange —New York Times.

Q. Publicly held corporations?

A. That's correct.

Q. Shares traded every day?

(p. 99) A. That's correct.

Q. Now, what does that have to do with Texas Monthly, Inc.?

A. It gives you a benchmark to say what the earnings of *Texas Monthly* are worth in the public market.

Q. Well, what are the total earnings of *Texas Monthly*, let's say, for that last year?

A. I'm not sure that's a—Your Honor, I'm sorry. I don't know if that's a piece of privileged information or not.

Q. Well, let me withdraw that question. Can you calculate the price earnings ratio of *Texas Monthly?*

A. Yes, it's 17.8 on January 7th, 19—

Q. No, sir. I'm asking you you've told me how you calculate price earnings ratios. You take their earnings, and you divide it by the price of that stock at any point in time, and I'm asking you how can you calculate for me what the price earnings ratio of *Texas Monthly* is?

A. *Texas Monthly* is not a publicly held company. So obviously it has no stated price earnings ratio. If tomorrow we did a public offering of *Texas Monthly* and we sold a million (p. 100) shares of stock, it would have a stock price of about $35, and that would be—

Q. How did you get that?

A. That would be simply their earnings divided by a million shares of stock outstanding divided by the PE ratio that the market would value the company at.

Q. What are their earnings to arrive at $35?

MR. GEORGE: Your Honor, we have a protective order about certain financial data regarding the underlying value. I'm not sure what—honestly what this all has to do with the valuation he's gone through—a price earnings ratio, which is obviously—

THE COURT: What is your purpose, Counsel? What are you trying to show the Court? I'm interested, of course, in knowing what you're trying to show the Court.

MR. MENDEZ: I may be a little bit too paranoid, but what's going on here is somebody goes to the New York Stock Exchange, and we've got five relatively big companies there. We don't know what their operations are. There's no evidence here about (p. 101) what's going on with regard to those companies and where they're selling things, and we have a ratio there, 17.8, that wasn't even calculated by this person. It was calculated—it was taken directly from the records, I guess, of the *Wall Street Journal* or whatever of January the 7th, and then we're taking that number, and we're saying *Texas Monthly* has a loss of 3.1 million dollars because of that 17.8 number. Those companies have nothing to do—those operations have nothing to do with what *Texas Monthly* does because *Texas Monthly* isn't publicly traded. In fact, you can't even calculate a price earnings ratio for that company. Now, what I'm showing goes to the weight of the evidence. I was trying to figure out how to object to these exhibits, but what it goes to is really the weight. I'm trying to show that you can't use one number to get to the other, and that's the only reason I'm trying to—

THE COURT: All right.

MR. MENDEZ: If I may continue, Your Honor?

THE COURT: I still don't quite understand, but I'll let you continue. (p. 102) I'm not—continue with cross examination.

MR. MENDEZ: Okay. Can I ask him that question as to how he figured out their price earnings ratio and how he knows that it's the same as—

MR. GEORGE: Your Honor, the man has answered the question. There is no established—the problem, of

course, is that *Texas Monthly* is not publicly trade. So we can't look up their price. The element in determining a ratio requires two things—a price and earnings. We do not have a price for *Texas Monthly* because there is nobody buying and selling the stock.

THE COURT: I understand.

MR. GEORGE: Yes, sir, but he—

MR. MENDEZ: But he went one step further—well, go ahead.

MR. GEORGE: He has answered the question in saying that he has taken a ratio that is available for similar companies that do trade and do have prices and do have earnings both, and he comes up with a composite number of 17 percent as the ratio for (p. 103) thos ecompanies and assumed, for the purpose of coming up with his estimate of damages, that *Texas Monthly* would trade, if it was sold, at the same ratio those companies do, and then applied that ratio number to the—

THE COURT: I understand what he's done. I'm just trying to get what—

MR. GEORGE: And I'm not sure—and Mr. Mendez has asked him what's the price for *Texas Monthly* three times, and he says there's no price, and he's asked it again. That was his last question, and that's been asked and answered is the subject of my objection.

THE COURT: All right.

MR. MENDEZ: What's my instruction, Your Honor? I can't ask him—

THE COURT: Well, ask him—what was your last question? I want to know—

MR. MENDEZ: He said on his last response that *Texas Monthly*, if you sold it on the open market tomorrow, was $35 per share.

THE COURT: Okay. You have your answer then.

MR. MENDEZ: I want to (p. 104) know how he figured out he got the $35 because then he's got a price earnings ratio—assuming he wants to get into that. I mean, if he wants—I mean, I guess he can't withdraw his answer. I can go on to another topic. I think I made my point on that.

THE WITNESS: Mr. Mendez, maybe I can be helpful to you.

QUESTIONS BY MR. MENDEZ:

Q. No, let me just ask you some questions in another area, and we'll try to figure this out. There's a little box on plaintiff's Exhibit No. 52. Do you see that boxed off area on the bottom that Mr. George set up there?

A. Yes, I do.

Q. Two things you can arrive at from that set of numbers, right? One is the thing you came up with that—

THE COURT: What box are you talking about, Counsel?

MR. MENDEZ: That square box over here.

THE COURT: Oh, you're talking about where the percentages are? All (p. 105) right.

QUESTIONS BY MR. MENDEZ:

Q. Now, Mr. Lepere, you'll agree with me that there's two things you can come up with from there. You can come up with the conclusion from that that there's an average of a hundred and ninety-one point two percent premium paid when somebody purchases—does a buy-out of companies; is that correct?

A. That's the premium that has been paid over the last few acquisitions for a majority interest in the company.

Q. On those—no, those five companies?

A. On those five or six companies, yes, whatever it is.

Q. Because there's another thing that's real apparent when you look at that, and isn't it fair to say that depending on what deal any purchaser—any person that's conducting a buy-out, leveraged or otherwise—depending on what kind of deal he can cut, that makes the premium? Isn't the premium the amount he paid over what the net worth of that stock is?

A. I wish it were that simple in the magazine business. It never seems to be.

(p. 106) Q. Well, sir—

MR. GEORGE: Please let him finish his answers.

THE WITNESS: I don't—I don't understand some parts of magazines, I guess. I don't understand why people put such high premiums on them but they do. A lot of it has to do with wanting to own it. A fellow by the name of Cy New'house bought *The New Yorker* at

an extraordinary multiple of earnings, and would I pay that much for that business? No. A fellow bought *U.S. News & World Report* for four times its then appraised value, five times its—or six times its previously appraised value on a book value that I think was around 23 million dollars, and he paid 59 times earnings for the business. Why did he do that? I don't know.

Q. Okay, sir. So then it's really fair to say that the fact that division of X Company was bought out at a 25 percent premium and Chilton Company up right above it was bought out at 231 percent premium—there's an intangible factor in there, and no one can figure out—you can't figure out, and you're the expert— can't figure out why there's a difference in (p. 107) these premiums?

A. Mr. Mendez, someone made a judgment on all of those companies. Someone made a judgment. They determined that this is the price they wanted to pay for it on an economic basis and, I believe, on an emotional basis. Why they arrived at that number, I can't deal—I mean, people do funny things. That's the number they arrived at, and that's what they paid, and rather than dealing with again a lot of psychological reasons why Cy Newhouse wanted to buy *The New Yorker* and have it in his publishing stable, these are the facts. ABC bought Chilton. It was a big publicly traded corporation. Why they agreed to pay a 231 percent premium for Chilton is beyond my comprehension, but as a practical matter they did. You can't change that.

Q. Is that the end of your answer?

A. I think you're—I don't know what you're driving at. These are indeed things that have occurred. They

are fact. They aren't figments of someone's imagination. I think there are, you know, any number of people in the State of Texas who would pay a large premium for (p. 108) the ownership of *Texas Monthly*. It's considered a very prestigious magazine in this state.

Q. So your testimony is that, regardless of what reason they might have had for buying them out at different prices on these premiums, you've taken an average, and you've applied that average, 191.2 percent, to *Texas Monthly*?

A. That's correct.

Q. And is it fair to say *Texas Monthly* is not a publicly held corporation?

A. *Texas Monthly* is not a publicly held corporation.

Q. And we don't know—you don't know what somebody might pay to buy it?

A. Neither was *U.S. News & World Report* a publicly held company.

Q. No, sir. I'm asking about *Texas Monthly*?

A. No, it's not a publicly held company. I can speculate on it, but by way of comparison, *U.S. News & World Report* was not a publicly held company.

Q. Okay. I just have a couple of questions left. Going back to that Maryland (p. 109) company, I don't remember what your testimony was, but I want to get it on the record. Was it your testimony that after your study was done on the solicitation effect or the effect on the

solicitation of that company of the tax—did it reduce circulation?

A. We made a judgment call that it had a negative impact on our circulation results, and we have a small circulation. So the percentages get to be more important, and we made a determination to pay the tax ourselves, rather than run that risk.

Q. Okay, sir, and you've testified today about your knowledge of some tests done by Texas magazines. Can you tell the Court the magazine names that were involved?

A. One was *Houston City* magazine published in Houston. One was *D Magazine* published in Dallas, and the other one was, of course, *Texas Monthly*.

Q. Okay, and are you aware of any other tests that might have been done?

A. Not specifically related to this state.

Q. Okay, and do you know if those (p. 110) companies are still operating?

A. All three of them are operating to my knowledge.

Q. And do you know how they decided to treat the sales tax or use tax?

A. Well, I think *Texas Monthly* has decided to—they would have to pay it out of their own pocket, and I'm not sure how the other ones have treated it at this point.

Q. Okay, and is it also your testimony that the Maryland company is still paying its sales and use tax?

A. It is paying a gross receipts tax right now.

Q. What gross receipts tax applies to that company, sir?

A. We get so much amount of the subscription revenues, and we take X percent of it as sales tax and pay it.

Q. What is the statute that specifies that there is an occupation tax on newspapers or magazines in Maryland, sir?

A. Mr. Mendez, I'm not a tax lawyer. I am not an Attorney General, but my God, you know, if it waddles like a duck and it quacks (p. 111) like a duck, chances are it's a duck.

Q. Is it your testimony that *Baltimore Magazine* is still paying its sales and use taxes in the State of Maryland?

A. Yes, it is my testimony they are still paying the State sales whatever tax in the State of Maryland.

Q. And is it your testimony that you're not aware of any gross receipts tax on the occupation of publishing magazines in the State of Maryland?

A. I am not aware of any, and the way we list it is the subscription price includes X amount and the sales tax.

Q. Okay, sir, and is it your testimony that that company is still in business in Maryland?

A. It is still in business in the State of Maryland.

MR. MENDEZ: Pass the witness.

REDIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Very briefly let me go over a couple (p. 112) of things. First of all, data available on offices of magazine companies—is there a standard rate and data publication, a booklet or data base that shows information about magazine publishing companies?

A. Yes, there is.

Q. And who uses that?

A. Oh, primarily advertising agencies and other people who buy media. It lists mechanical requirements for the magazines. It lists circulation. It lists regional editions. It lists head operating personnel.

Q. Does it list where it has advertising sales—advertising agency—

A. I think it does.

Q. So if I'm a Dallas advertising agency and I want to put in an ad about the InterFirst Bank Holding Company, I could look in there and find out whether a regional edition of *Newsweek* is published and if they have a Texas office?

A. Yes, I'm almost positive you can.

Q. And in connection with the companies—I'm not going to ask you specifics, but in connection with—let's take the Washington (p. 113) Post Company, *Newsweek* publisher, the *U.S. News & World Report*. What's the range of fees you charge to those companies on an hourly or daily basis that they pay you?

A. Could I get off the hook by just saying excessive?

Q. If you could give a range of low to—

A. I do very little work by the hour, but I charge $350, if someone really insists on it.

Q. And that's for valuing magazine companies?

A. It could be for—for any number of things that they may call me in for.

Q. Now—

MR. GEORGE: Pass the witness.

RECROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Well, sir, you're familiar with the SRDS. Is there a compulsory set format to put things in the Standard Rate and Data Service?

A. I'm not sure what you mean by—

Q. When you submit information to the (p. 114) Standard Rate and Data Service, can you publish anything you want to from your rate card, or is there a standard compulsory format that you've got to fit into to get it on SRDS?

A. There's specific information they want you to list.

Q Do you know for a fact that it is a requirement of the Standard Rate and Data Service to require you to list all of your locations or offices on that publication?

A. Mr. Mendez, Standard Rate and Data is a publication. I think it's published monthly or quarterly. I don't recall right now. It is designed so advertising media plan-

ners have easy access to data on specific media, in this case, magazines, and a magazine would be foolish not to list all its advertising offices or all its offices. It wouldn't make any sense.

Q. Sir, I'm asking you if there is a requirement in describing or sending in an advertisement for Standard Rate and Date [sic] Service that you put in there what offices you have located throughout the world?

A. What they're listing in there isn't an advertisement. What they're listing is an (p. 115) editorial column basically on *The New Yorker,* for instance, and *The New Yorker* is going to want the advertising community at large to know where its advertising offices are.

MR. MENDEZ: Your Honor, we have no further questions at this point, but we may want to recall this witness at a point later during our case.

MR. GEORGE: I have no more questions.

THE COURT: You may step down.

MR. GEORGE: Can we put him on call at least?

THE COURT: How available would he be on call?

MR. GEORGE: I'm through with him but—

MR. MENDEZ: I've got some stuff back at the office that I want to show him and see if he can—

THE COURT: When do you want to do it? That's what we're trying to get—the time schedule.

MR. MENDEZ: Well, we'll (p. 116) do it sometime this afternoon. Well, I don't know when they're going to rest.

MR. GEORGE: I should rest before the lunch hour and he has—would like to get out of here this afternoon, if we arrange to cross him right after lunch.

MR. MENDEZ: We'll do it right after lunch.

THE COURT: All right. Be back after lunch then.

MR. GEORGE: We'd call Mary Mizwa.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 54 through 56 for identification.)

MARY MIZWA

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. Mary Mizwa. I live at 1205 Cress in (p. 117) Houston, Texas.

Q. How are you employed?

A. I am the circulation director for *Southwest Art* magazine.

Q. And can you describe *Southwest Art* magazine?

A. It is a special interest publication with national distribution. It is what we call a prepaid publication. There is no billing of subscriptions.

Q. Okay, and is its home office in Texas?

A. Houston, Texas.

Q. I'll hand you what has been marked Plaintiff's Exhibit 54 and see if that's a copy of your publication?

A. Yes, this is our current issue, February.

MR. GEORGE: I offer Plaintiff's Exhibit 54.

MR. MENDEZ: Let me see if it has a thing in it that I was looking at before. No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

(p. 118) Q. Do you sell that magazine by subscription?

A. Yes.

Q. Okay, and do you have subscriptions sold to Texas residents?

A. Yes.

Q. Where is the magazine printed?

A. Houston—or the magazine is printed in Virginia.

Q. And is it trucked to Houston for mail to Texas residents?

A. Yes.

Q. By the printer?

A. The printer trucks it to Houston and delivers it to the post office where it's mailed.

Q. And do—have you added any instructions on your order form to ask Texas residents to pay sales tax?

A. Yes, we have.

Q. Okay, and what have you said?

A. We say, "Texas residents add a dollar sixty-eight sales tax" or in some instances a dollar sixty-nine. It's a rounded off number.

(At this time an (p. 119) instrument was marked as Plaintiff's No. 57 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what has been marked Plaintiff's 57 and ask you if you can identify that?

A. Yes, this is a subscription offer that we ran beginning in our October issue, which was part of a Christmas offer.

Q. Okay. Is there a reference to the Texas residents add the tax?

A. Yes, add six and one-eighth percent sales tax on these particular ones.

MR. GEORGE: I'd offer Exhibit 57.

MR. MENDEZ: No objection, Your Honor.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Can you tell the Court how long you have been making an effort to get Texas residents to add the sales tax?

A. We began in October because all of our information was preprinted, and we waited until we reprinted, and when we reprinted we (p. 120) added the sales tax.

Q. Okay, and what has been the response?

A. Well, it's been a very poor—two percent is the most we've had respond to it.

Q. That is, of the orders you get from Texas residents, only two out of 100 people pay the sales tax?

A. Will pay the sales tax, right—a little over two percent.

Q. Have you produced a summary of those results?

A. Yes. This is our October and November results.

Q. And that's Plaintiff's Exhibit 55? You have to say verbally—

A. Yes.

MR. GEORGE: I'll offer Plaintiff's Exhibit 55.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Is there any practical way for you to collect the tax from the people who don't pay the tax?

A. There is no way we can collect it (p. 121) because we do not bill, and it would just be prohibitive.

Q. For the price of the—

A. We don't have a computer program that sends—does invoicing.

Q. And the price of sending out a bill for 50 cents—

A. It would be too much.

Q. Now, I want to make this clear. They pay—

A. In advance—our subscribers. We do not bill at all, and we state that on the form. "Sorry. We do not bill."

Q. And so you have a subscription price of $27.50?

A. That's right.

Q. And your—98 percent of the people send in the purchase price but not the tax?

A. That's right.

Q. And—

A. The only ones that we get—that we have any option at all of collecting tax from are those who pay by credit card, and on the credit card sales we add the tax.

Q. You just add it to their bill?

(p. 122) A. We add it to it. That's right.

Q. And do they make outcry when they get their bill?

A. Yes, we had quite an outcry.

Q. They don't know that when they—

A. No, they don't know that when they give us the credit card number.

Q. And how many of your bills are credit card?

A. Our credit cards really run depending—around Christmas time we had more, but average is around 20 percent of our subscription payments.

Q. And how much of your total circulation is by subscription?

A. Our total circulation?

Q. How much is newsstand, and how much is subscription?

A. Well, about 44,000 is paid subscribers, and around 9,000 is newsstand.

Q. So the subscription sales is the vast majority of your sales?

A. Yes.

Q. Okay. I'll hand you Exhibit 56 and ask you if you can identify that?

(p. 123) A. Yes. This is our state by state breakdown, which we did for the latest ABC audit report.

MR. GEORGE: Okay. You've seen this, Counselor?

MR. MENDEZ: Yes, sir.

MR. GEORGE: I'll offer Exhibit 56.

MR. MENDEZ: No objection, Your Honor.

THE COURT: Admitted.

MR GEORGE: Pass the witness.

CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Ms. Mizwa, we talked on the phone the other day, didn't we? Okay. Now, what was your previous response rate to your insert cards before you changed to this—to adding the Texas sales tax?

A. Well, we haven't noticed any appreciable difference in the response. You mean to our bind-in cards?

Q. Yes.

(p. 124) A. None.

Q. Okay. Now, you mentioned that there was a two percent response rate to one of the documents. Which one of the ones was the one that you had?

A. Well, that was our—the two percent response was, I believe, in November. In October in the first month it was just a little over one percent.

Q. And those are persons—that's your net response of persons that subscribe to your magazine?

A. The Texas residents.

Q. That—

A. That pay the tax.

Q. Okay. In their orders that are for your—

A. In their cash they added the sales tax.

Q. Okay, and now did you use this type of subscription offer before November?

A. Yes, we've used the same type bind-in card consistently.

Q. Okay. Now, before you added in the language about the sales tax—let's say, the (p. 125) month before that, do you have any records as to what the percentage response was to these bind-in cards?

A. I do but I don't have it with me. It would also be hard to judge because the time we did the new one it was a whole new promotion, and our history is that when

we do a new bind-in card we get a better response the first two months. So it would be hard to judge.

Q. Okay. Now, what's the percentage of circulation that you have in Texas as compared to your total circulation?

A. 23 percent.

Q. Okay, and how much of that is by subscription?

A. How much of that 23 percent?

Q. Of that 23 percent is by subscription?

A. Oh, I forget. May I look at that? I just did these new numbers. Just a moment. Of that 10,000, 403 are Texas subscribers, and 2,500 and—I'm sorry—2,356 are newsstand, and we have a total subscription in Texas of 12,759.

Q. Now, ma'am, how long have you been (p. 126) publishing—how long has the company been publishing that magazine?

A. 14 years. We're staring our 15th year in May.

Q. Okay, and what kind—what's the demographic profile of persons that you attempt to sell this magazine to, if you have any defined group?

A. Well, our advertising department says they're Reaganites, if that means anything.

Q. Okay, and have you made a business—

THE COURT: Rich? Is that what you mean?

QUESTIONS BY MR. MENDEZ:

Q. Now, do you know that persons that might subscribe to *Texas Monthly* might subscribe to your magazine?

A. Yes, we are getting some cross over because they do have what's known as yuppies, and those are a new group that we've gone after with some campaigns lately. So we would have some cross over readership.

Q. These are people that want to be rich, and they're working on it?

A. They're spending their money— (p. 127) maybe not saving any.

Q. Well, ma'am, were you with this publication back prior to 1977?

A. No.

Q. Okay. Do you have any idea whether or not *Southwest Art* collected sales and use tax back before 1977 when the subscription exemption came into place?

A. No, I have no knowledge of any of that.

Q. Now, ma'am, I guess it was a business decision of the corporation to add that language into your binding cards; is that correct?

A. Yes, it was a business decision after we realized how much we would have to pay if we did not add it.

Q. Okay, and I guess—have you made any decisions, based on the responses that you're getting of collecting this tax, to whether or not to maintain that language in your insert?

A. We probably will not because we're collecting so little of the money, and the philosophy in subscription sales is to make the (p. 128) offer as uncomplicated as possible, and even though we have even stated the exact amount, we don't seem to have any luck. So—

MR. MENDEZ: Pass the witness.

MR. GEORGE: I have no further questions. Thank you very much for coming.

THE WITNESS: Thank you.

MR. GEORGE: We would—may she be excused from the rule?

THE COURT: You may be excused.

MR. GEORGE: We would rest at this point in time.

THE COURT: All right. Then we'll take our noon recess then, unless you've got something short you want to put on.

MR. MENDEZ: No, sir, Your Honor, I'd rather wait, if you don't mind.

THE COURT: All right. We'll start up at 1:15 then, since we're recessing this early.

(At this time a lunch recess was taken, after which time the (p. 129) proceedings continued as follows:)

MR. MENDEZ: If we may, Your Honor, sort of before we begin our presentation, I want to recall Mr. Lepere so he can get out of here.

THE COURT: All right.

(At this time there was a brief discussion off the record.)

RICHARD L. LEPERE

was recalled as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Lepere, you were stating that *Texas Monthly* publishes its rate card and some of its information in the Standard Rate and Data Service, and that that's a document that advertisers might use; is that correct?

A. That's correct.

Q. Okay, and just so that the Court can get an idea of what that publication might be like, I'm going to hand you a document which Mr. George has been looking over, which is—and (p. 130) could you identify that document? I'm not having it marked.

A. Well this is the Standard Rate and Data for newspapers, which covers newspaper rates and mechanical data and production data.

Q. Okay, sir, and is that a document commonly used in your industry?

A. No, we use the one that is—what is referred to as the SRDS for consumer magazines and foreign publications is the category.

Q. Okay, sir, and is that type of—does it look something like that document?

A. Yes, very similar.

Q. Okay, and could you explain for the Court what's in the magazine SRDS—what type of information one would put in there?

A. Well, there's—here is the information on *The Huntsville Times*, which is a Newhouse newspaper in Huntsville, Alabama. It has the times it's published—evening and Sundays. It's got the names of some of the personnel—the editor and publisher, the marketing manager. It's got the representative of the branch offices of Newhouse newspapers. (p. 131) It's got the commissions and cash discounts to agencies. It's got sort of an all policy classification. I'm not sure what that is. I'm not that familiar with newspapers. It has the advertising rates effective April 1st, 1984, effective February 13th, 1984, and then it proceeds to give the advertising rates for the different editions. It has color rates and data—when they can accept color. When they can't accept color. It has split run, which is when you want one ad to appear in certain parts of the paper and another ad to appear in another portion. It's got mechanical requirements. It doesn't have copy and contract regulations. It directs you to somewhere else. It's got mechanical measurements.

Q. And sir, would it be fair to say that that's a type of information that you have in a magazine SRDS?

A. Yes, it's similar.

Q. Okay, and I guess the one point I wanted to—for you to see if you could agree with me on is that it may or it may not contain information about those com-

panies' locations, warehouses, distribution points in any (p. 132) particular state?

A. Mr. Mendez, it is highly unlikely that *The Huntsville Times* is going to be soliciting advertising in Dallas, Texas.

Q. Well, sir, what I'm asking you is in a magazine SDRS—and you had stated that that publication would have this type of information. I'm asking you if you can agree with me that it might for any particular magazine—and we're talking generically and in there—anything that's published in SRDS for magazines—that it might or it might not have a list of every facility that that company has in any particular state?

A. We never discussed any facility. We discussed advertising and sales offices.

Q. Well, I'm asking you can you agree with me that it might or it might not?

A. It is not going to list the facility in SRDS. If they happen to have a warehouse in Tuscaloosa, Alabama, it's not going to list it. It may list advertising sales offices, which is what the purpose of this is.

Q. That's what I wanted to get at. Are you familiar with the Ayer Directory?

(p. 133) A. Yes, I am.

Q. Okay, and do you know if *Texas Monthly* is published in that?

A. I do not. I have not looked at it for a number of years.

Q. If I handed you a page from the Ayer Directory, would you be able to identify it just by looking at it—any particular page?

A. Most likely.

MR. MENDEZ: Okay. I'm going to have this marked as Defendants' Exhibit No. 2.

(At this time the instrument referred to was marked as Defendants' Exhibit No. 2 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. Now, sir, I'll hand you what has been marked Defendants' Exhibit No. 2. Does that look like a page of the 1984 Ayer Directory?

A. It says at the top, "IMS '84 Ayer Directory of Publications."

Q. And from your experience with this publication, does this look like it's from there?

A. Yes, it does.

Q. Okay, and does it state *Texas* (p. 134) *Monthly* in there?

A. Yes, it does.

Q. And what information does it give you about *Texas Monthly*?

A. It gives name, the way it's printed, offset, established 1973, monthly, general interest, black and white page rate, four color rate, columns, widths and depths, subscription rate, name of the editor, name of the publisher, name of the advertising director, and that's it.

Q. Okay, and it states—

A. And circulation. Excuse me.

Q. And it states its location in Texas; is that correct?

A. Actually it has Post Office Box 1569 and then a zip code. It never says exactly where it is.

Q. And it doesn't state anywhere on there about its advertising offices in any particular—

A. But it wouldn't. That's not what this directory is for.

MR. MENDEZ: I'll pass the witness.

MR. GEORGE: I don't have (p. 135) any more questions for Mr. Lepere. May he be excused?

MR. MENDEZ: I don't have a problem.

THE COURT: Thank you. You may be excused.

MR. GEORGE: You're welcome to sit in the courtroom or go catch your airplane.

MR. MENDEZ: We'll offer that exhibit, Your Honor.

MR. GEORGE: No objection.

THE COURT: Admitted.

MR. MENDEZ: Before we start our witnesses, Your Honor, if I may, if I can diagram something of what we're going to be doing so you can—

THE COURT: Surely.

MR. MENDEZ: Your Honor, what we're going to show you, starting this afternoon and hopefully finishing

as soon as possible, is what the Comptroller does and how he does his work. Throughout the course of the plaintiff's case, there have been some witnesses called, and they've been asked questions about (p. 136) specific tasks and what their relationship is to that. What we're going to show you now is how the Comptroller goes about dealing with these problems, and we're going to show you, I think, that he has a limited set of resources that he has to allocate in the wisest way, and that's what the Legislature gave him to work with, and he tries to use it as effectively as possible.

We're going to be talking about three groups of people. Tax administration is one group of people, and we're going to put a witness on to explain what they do, and then we have another group that is the enforcement group, and we'll explain how they get out there and collect taxes and find people that owe taxes or might owe taxes, and of course, our audit.

Superimposed on all of this—on these three areas—and I'll be filling in as we go through it—will be evidence about new tactics that the Comptroller has taken that you may have heard about in the paper and on television that will relate to how to do this type of work—tax collecting, as to out of state, non-permitted sellers of goods (p. 137) into the State of Texas, and there will be two or three different kinds of those sellers—people that don't have nexus and people that have nexus and people that we're having trouble finding, and so with that in mind, we'll call our first witness, who is Wanda Hutcheson.

WANDA HUTCHESON

was recalled as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Now, Ms. Hutcheson, you gave testimony yesterday in this case, did you not?

A. Yes, sir.

Q. And you were asked about a lot of things that you didn't do. So now we know what you don't do. What I'd like for you to tell the Court this afternoon is what does the Tax Administration Division of the Comptroller's office do? What are its functions, and then we'll move on to the policy section.

THE COURT: Let's keep it short and brief and general. I don't want to (p. 138) try this lawsuit—because I'm sure there's enough that you could bring in your testimony to what the Comptroller does that will be irrelevant. Let's keep it relevant.

MR. MENDEZ: Yes, sir. That is exactly what we're trying to do.

QUESTIONS BY MR. MENDEZ:

Q. What does the—can you explain the function of the Tax Administration Division in enforcing any of the —the sales and use tax?

A. Well, tax administration basically is in—separated into three areas. You've got taxpayer assistance.

That section normally makes up our phone bank, and they are the people who answer sales tax questions from the public on—as well as other franchise tax and other taxes, but they do answer tax questions from the public.

Q. Okay, and with respect to this phone bank, is that your 1-8[illegible] number that's available to persons throughout the state?

A. Yes, sir, it is.

Q. And if someone had a question about his or her use tax liability for a magazine, would they be able to contact this phone bank (p. 139) and get information about that—the policies of the Comptroller's office with respect to use tax?

A. Yes, sir, they would. If it was established policy, the taxpayer assistance group should have that information, yes, sir.

Q. Okay, and is the—that 1-800 number published throughout Texas?

A. Yes, sir, it is.

Q. Now, does that phone bank also have fixed—foreign exchange lines to various cities in the state so that people can call their local number and get somebody here in Austin to talk to on the phone bank?

A. Yes, sir, that's correct.

Q. Now, and anybody that—would anybody that called on that phone bank and asked about his use tax liability as a consumer have been told not to file a return?

A. Has anyone been told not to file a return?

Q. Yes.

A. Not if it's an item subject to sales tax being discussed, no, sir.

Q. And if someone wants to voluntarily (p. 140) remit taxes and identifies themselves as such on this—to this phone bank, would they explain how to get a permit or how to file that money?

A. If a person had use tax to report, they would be told how they could turn it in, yes, sir.

Q. Okay. What other divisions does the Tax Administration Division have?

A. Well, we have a support group called office management, and they help with the forms. They help with small computer runs—that sort of thing in support of the other two divisions.

Q. Okay, and what is the other division?

A. And then finally we have the tax policy section, the one that I'm most familiar with.

Q. Okay, and you are the supervisor?

A. Supervisor of the sales tax policy, yes, sir.

Q. Okay, and could you describe for the Court briefly what types of things tax policy is responsible for?

A. Well, I think our primary concern is answering sales tax questions from both permitted taxpayers and from consumers. We'll (p. 141) answer telephone—questions by telephone. We'll answer them by letter. We answer questions from field personnel, permitted taxpayers

and consumers. We write sales tax rules. We issue policy statements. We assist our legal services division in writing their positions to—what we call position letters when a person has been audited and is going to reach determination hearings.

Q. Would you train individuals in the Comptroller's office as to what the policy was?

A. We do extensive training. We make speeches. We have a training center in Kerrville that we provide subject matter experts for.

Q. Okay, and do you review any of the publications that might go out from your agency that have information about substantive law or the substantive tax?

A. Anything to do with the sales tax—we would review it before it went out to be sure that the information was correct and current, yes, sir.

Q. Okay. Would you have an occasion to make video tape presentations that are available (p. 142) to the rest of the agency that can be used on substantive policy or on procedural policy?

A. We have assisted in video tapes and in radio commercials—I mean, radio spots also.

Q. Okay, and is all of this to try to get the information out to the rest of the people in your agency?

A. To be sure that everyone is being given the same information and that the information is current, yes, sir.

Q. Now, let's say that somebody called the tax assistance group and had a difficult question about sales

tax. Would those types of questions be referred to policy, or would they be referred to some other group?

A. They would be referred to policy, yes, sir.

MR. MENDEZ: Okay. At this point I'd like to have some exhibits marked, Your Honor.

(At this time instruments were marked as Defendants' Exhibits Nos. 3 through 11 for identification.)

QUESTIONS BY MR. MENDEZ:

(p. 143) Q. Ms. Hutcheson, I'm going to hand you a group of exhibits, and we'll go through them in order. We'll start with No. 3. Can you identify that exhibit?

A. Yes, sir. That's a reprint of the Limited Sales Excise and Use Tax Act with the changes made by the special session in the last session of the Legislature included.

Q. Okay. Did the Tax Administration Division get that—review that and make sure that it has all of the statutes on sales and use tax?

A. Yes, we did.

Q. Okay. Is that document available through the Comptroller's office to anybody that asks for it?

A. Anybody that wants it can have a copy, yes, sir.

Q. Okay, and if you go out and do a speech to a group of, let's say, publishers, would you haul a group of those sales and use tax statute books with you and hand them out?

A. If we thought it was appropriate, yes, sir.

Q. Okay. I'm going to hand you a copy (p. 144) of what's been marked Defendants' Exhibit No. 4. Can you identify that document?

A. Yes, sir. That is Rule 3.346 of our use tax rule.

Q. Okay, and did you promulgate that in accordance with the rules of—the Texas Administrative—

A. Procedures Act.

Q. Yes.

A. Yes, we did.

Q. Okay, and is that rule published and available through the Comptroller's office?

A. Yes, it is.

Q. Okay, and that's in the same way that the statute book is, is it not?

A. Yes, sir, and it's available in this form to anybody that wants it.

Q. Okay, and does that inform taxpayers of their obligation to pay use taxes?

A. Yes.

Q. And I have a document here which has been marked Defendants' Exhibit No. 5. Could you identify that document?

A. This is a document that we prepared—or that was prepared right after the special (p. 145) session. It was prepared mainly for the Texas State Fair in Dallas, and then it was sent to all of our field offices so that the public could have some information on the new taxes.

Q. Okay, and did you help prepare that document?

A. Yes, sir, we did.

Q. Okay, and you say that that was made available at the State Fair to all consumers that were out there?

A. That's correct.

Q. What does it say about magazine subscriptions in that publication?

A. It has one sentence about magazines. It says, "You now pay sales tax on newspaper and magazine subscriptions and over-the-counter sales."

Q. Okay, and now I hand you what's been marked as Defendants' Exhibit No. 6. Can you identify that document?

A. Yes, this is the sales tax review—the October 2nd, 1984 edition, and this was a publication that was prepared and mailed to all persons who hold—who held Texas sales or use tax permits in October of 1984.

(p. 146) Q. Okay, and Ill hand you as a group Defendants' Exhibits 7 through 10, a group of brochures. Could you further identify those documents?

A. Exhibit No. 7 is a brochure entitled the Texas Use Tax. No. 8 is a brochure entitled Sales Tax Permit, No. 9, Boat Dealers and Buyers, and No. 10, Texas Tax Deadlines.

Q. Now, ma'am, are those again documents that you've reviewed and for substantive policy in your office?

A. Yes, that's correct. These are the type brochures that we do review and do have printed.

Q. Do you have knowledge as to where these documents are put or sent?

A. They're available at all of the field offices in the area. We have some at—we did have. I'm not sure now whether we do or not but we did have some at all of the courthouses—anyplace that the public can get hold of them.

Q. Okay, and it states that—there's a use tax one in there. Does it contain information about when you have use tax (p. 147) liability?

A. Yes, sir, it does.

MR. MENDEZ: I'll offer Defendants' Exhibits 3 through 10.

MR. GEORGE: No objection.

THE COURT: Admitted.

MR. GEORGE: Can I see those, please?

QUESTIONS BY MR. MENDEZ:

Q. So does—is the phone bank available for use by enforcement officers that might not understand a particular policy point, if it comes up in the field?

A. Yes, sir, the enforcement people and the audit people are aware of the phone bank. They can call either the phone bank or policy when they have questions.

Q. Okay, and now, there was some testimony that you gave yesterday—well, before we go to that, is it your responsibility to go out and find taxpayers that may need permits?

A. No, sir, it is not.

Q. Okay. Is it your responsibility to examine taxpayers' records to determine if they (p. 148) have an audit liability?

A. No, sir, it's not policy's responsibility.

Q. So if somebody asked you why you hadn't gone to check on some Boy Scout Troop or Girl Scout troop about their sales tax liability, is that something that's within the scope of your employment?

A. No, sir, it is not.

Q. Is it your understanding that there may be other people that do that job?

A. There are other people in the agency whose job that is, yes, sir.

Q. Now, you were a member of the tax policy committee, and you testified about that yesterday—what the tax policy committee didn't do. Could you explain what it was created for and who created it?

A. Right after the special session we were beseiged with questions from taxpayers who were affected by the changes in the special session. So to ensure that the answers all came from the same place and that we could have some control of what the answers were given and that they were consistent and correct, Mr. Bullock (p. 149) formed the policy committee, and the policy committee was there for the purpose of answering questions on the law, and if a particular group came in with a question—a particular question on their responsibilities, we were there to respond to specific situations.

Q. Okay. Were you supposed to make decisions about all of the use tax or just the use tax changes that had come into effect?

A. The policy committee formed at that time was only for the special session.

Q. Okay, and how many different problems—can you identify how many different tax changes there were in the statutes that the committee might have dealt with?

A. I can't give you a specific number because they were numerous. We're still discovering areas that are under the new tax that we weren't aware of at that point in time.

Q. Okay, and did you-all consider magazines as a group—magazine publishers as a group in any of these meetings and decide one way or the other whether or not they were taxable or how they were to be treated for administration purposes?

(p. 150) A. No, sir, we did not.

Q. Okay, and was the policy committee responsible for checking out school children or, you know, Girl Scout troops to determine if they were liable for taxes?

A. No, sir. The only connection we had with groups of that sort—if someone asked if what they were—the specific activity they were engaged in—whether or not that activity was taxable, we would respond that it was taxable or it was not taxable, but that was as far as our responsibility went.

Q. Was there any change in the nexus law during this special session?

A. No, sir.

Q. So did the committee have to address any issues of nexus or what constitutes doing business in Texas?

A. No, sir.

Q. Okay. Now—so when Mr. George asked you about verifying those numbers that Mr. Gerhart had given to you and you said that you hadn't verified them, is that a job that's normally within the scope of the policy committee or within the job of the sales tax (p. 151) policy group?

A. I guess I don't remember what numbers you're talking about.

Q. Well, did you have some meetings with Mr. Harry Gerhart?

A. Yes, we did.

Q. Okay, and at one of those meetings did Mr. Gerhart identify to you the potential amount of sales tax that he thought should be collected from certain taxpayers that he identified to you?

A. That could have happened at the first meeting. I was more—an observer at the first meeting than I was a participant, and I think that he did provide some information of that sort at the first meeting.

Q. Did you do anything with that information?

A. With that information, no, sir, I did not.

Q. Is that part of your task in the tax policy committee?

A. No.

Q. And in your role in the Tax Administration Division?

(p. 152) A. No, sir, it's not.

Q. Okay, and you took some lists from Mr. Gerhart at one of these meetings?

A. The second one, yes, sir.

Q. Okay. Did you do anything with those lists?

A. Yes, we did.

Q. Okay. Could you explain for the Court what you did with the lists after you got them?

A. We—when we decided to send out letters to the taxpayers listed on that—on that list that Mr. Gerhart provided, we did run some—run those names through our computer to see if some of those people already had permits so that we wouldn't send letters out to people who were already permitted.

Q. And what did you determine from that cross check?

A. Well, we did find some of those people on those lists that already held sales tax permits and were already remitting tax.

Q. Okay. Did you contact the rest of those people?

A. We sent out 76 letters, yes, sir.

(p. 153) Q. And what was your experience with respect to those letters?

A. All right. Now, those letters went out to people that Mr. Gerhart indicated might have representation and those that he thought did not have. I don't have a breakdown of the two, but we did send out a total of 76 letters, and we got 21 responses, either verbal or in writing.

Q. And the other 50 or so people did not respond?

A. Did not respond, no, sir.

Q. Okay. Did you follow-up on those anyway?

A. No, sir, we got—we got two applications in plus one letter stating that they were already reporting tax and gave us the number under which they were reporting. The rest of the people said that they did not have any contact or representation in Texas, but we did not follow it up—any of the rest of the letters.

Q. Did you send a letter to *Reader's Digest?*

A. Yes, we did.

(p. 154) Q. Okay, and I'll hand you what has been marked Defendants' Exhibit No. 11. It that the letter that you received from *Reader's Digest* in response to your mail-out?

A. Yes, it is.

Q. Could you read that first couple of sentences to the Court, please?

A. "In reference to your attached letter, please be advised that we are not engaged in business in your"—

MR. GEORGE: Excuse me, Ms. Hutcheson. Just for appearance sake, I would appreciate it if the exhibit was offered before it was read. I am going to object to the

reading of the exhibit before it's been offered. If you want to offer the exhibit, I will say I have no objection—

THE COURT: Why don't you offer the exhibit, Counsel?

MR. MENDEZ: We'll offer the exhibit. Well, let me see.

QUESTIONS BY MR. MENDEZ:

Q. Is that a record that you keep in your office?

A. Yes, it is.

(p. 155) Q. Okay, and that's—and you brought this over to us today; right?

A. Yes, we did.

MR. MENDEZ: Okay. I'll offer Defendants' Exhibit 11.

MR. GEORGE: I don't have any objection.

QUESTIONS BY MR. MENDEZ:

Q. Could you read the first couple of sentences to the Court?

A. "In reference to your attached letter please be advised that we are not engaged in business in your state. Under National Bella Hess our mail order sales are not considered taxable. We do not have offices, inventory, warehouses or people who maintain any of these items. Please adjust your records accordingly."

Q. Thank you. Now, do you—

THE COURT: Has this been admitted? You didn't have any objections?

MR. MENDEZ: [sic] I have no objection.

THE COURT: All right. Admitted.

QUESTIONS BY MR. MENDEZ:

(p. 156) Q. Now, with respect to this particular corporation, Ms. Hutcheson, do you have any further duties in the Comptroller's office or in the Tax Administration Division, as far as dealing with that company?

A. No, we do not.

Q. Okay, and if some other division might later try to contact them or attempt to audit them, that would not be a function of your office?

A. That is correct. It would not be a function of tax administration or tax policy.

Q. Are you familiar in your work with the Tax Administration Division, of any situations where persons might voluntarily remit tax?

A. Yes, they have voluntarily remitted tax before.

Q. And you've sat here and heard some testimony about situations of voluntary remittance. Could you explain what vehicle there is where some consumer can come in and remit these taxes?

A. If it's a one-time event—if they only have the use tax to report one time, we (p. 157) just tell them to turn it in. If they're going to have use tax on a continuing basis, we set them up so that they will get report forms on a regular basis so that they can report that use tax to us.

Q. Now, you've listened to testimony yesterday and today about how *Texas Monthly* magazine is delivered to Texas residents. If *Texas Monthly*—this is a hypothetical, let's say. If *Texas Monthly* delivered a magazine to you in Lockhart pursuant to a subscription sale, how much tax —what tax rate would apply to that sale?

A. In Lockhart it would be five and one-eighth.

Q. Is that the amount that *Texas Monthly* would have had to report on its sales and use tax return?

A. Yes, that's correct.

Q. Now, if they delivered the magazine to Red Rock, Texas, which is not on that list of tax—

A. Assuming Red Rock does not have local tax—city tax?

Q. Yes. How much would they have to—

(p. 158) A. Four and one-eighth.

Q. Okay. Now, if *Texas Monthly* could show you by zip code or otherwise that they were delivering a certain number of their magazines to places in Texas where they didn't have representation—and we're assuming they didn't have representation in Red Rock or in Lockhart—then would they have to pay at the Austin tax rate?

A. No, they would not.

Q. So to the extent that they might have delivered magazines to consumers in cities that are outside of Austin, then they might or might not have overpaid taxes?

A. That's correct.

Q. Okay, and if they had asked you—if *Texas Monthly* had asked you or your staff as to how to calculate the amount of tax for any particular individual, is this the policy that would have been disseminated to them?

A. Yes, it is.

Q. Okay. Do you know if they've asked what rate to apply to their report?

A. We may have discussed it. I'm not sure.

(p. 159) MR. MENDEZ: We'll pass the witness.

MR. GEORGE: Ms. Hutcheson, let me ask you a couple of things quite briefly, I hope.

(At this time there was a brief discussion off the record.)

CROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Ms. Hutcheson, we're talking about two issues—three issues that involve you in this case. Let's talk about one as collection from out of state publishers, okay?

A. Yes, sir.

Q. You understand, don't you, that people who do business in Texas under the definitions in the statute are obligated to collect the use or sales tax from Texas readers?

A. Yes, sir.

Q. You know that for a fact?

A. Yes, sir.

Q. And you know that there is a statutory definition of what constitutes doing buisness in Texas, don't you?

(p. 160) A. That's correct, yes, sir.

Q. And you know that that's contained in Section 151.107, don't you?

A. Yes, sir.

Q. And in that section there's two paragraphs, A and B?

A. Yes, sir.

Q. And A has to do with warehouses and the like, inventories in the state?

A. That's correct.

Q. And B, however, says you have respresentatives soliciting orders, doesn't it?

A. Yes, sir. Actually it's number two but—

Q. Number two. I'm sorry.

A. —the spirit of the thing is correct.

Q. Two?

A. Yes, sir.

Q. Subsection two of Section 151.107 in the tax code?

A. Yes, sir.

Q. And it says that's doing business in this state?

A. That's correct.

(p. 161) Q. And you got that letter from *Reader's Digest* when?

A. August 7th, 1985.

Q. Okay, and that's—since August 7th—that's about five months ago—you knew at that time that they had people soliciting orders in this state, didn't you?

A. No, sir, I did not.

Q. You were told by Mr. Gerhart in the fall that there was a general practice of having school children go door to door to solicit orders?

A. He did say that, yes, sir.

Q. Okay, and you believed it. You wrote Mr. Castlebury a memo saying that that was probably right?

A. What he said—I gave Mr. Castlebury a report on what he said, yes, sir.

Q. And you told Mr. Castlebury that those people were in the state, and you knew from your own experience because people would come to your house you told me on deposition?

A. That's correct.

Q. That people came to your house soliciting advertising—soliciting (p. 162) subscriptions?

A. For magazines in general, yes, sir.

Q. Yes, ma'am, and you—let me put it this way, Ms. Hutcheson: You certainly had good reason to believe that *Reader's Digest* had people soliciting orders in this state, didn't you?

A. I had no reason to think they did or did not. I had—I didn't think about them one way or the other.

Q. You knew that there was a general practice of people making door to door solicitations for advertising?

A. That's correct.

Q. For subscriptions to magazines, and you knew that there was a general practice of having school kids solicit them in Texas?

A. Yes, sir.

Q. And you knew those facts, and on August 7th you got a letter from *Reader's Digest* saying, "I don't have any inventories, and I don't have any warehouses, and I don't have any offices. So I'm not going to pay you any tax;" right?

A. That's correct.

(p. 163) Q. And you did absolutely nothing to see if the paragraph two of Section 151.107 was applicable to that company, even though you knew those other facts about the widespread use of soliciting agents in the state by magazines, and you had subscribed to *Reader's Digest* yourself?

A. That's correct.

Q. You didn't do anything about that?

A. That's correct.

Q. Okay, and you didn't report it to Enforcement Division?

A. We did not.

Q. You didn't report it to Audit Division?

A. We did not.

Q. You didn't do anything?

A. That's correct, we did nothing.

Q. That's right, and that's the general practice, isn't it? You've done nothing to this obligation for publishers up here—this part. *Texas Monthly* is supposed to collect, as required and forced to collect the tax, but *Reader's Digest* isn't, even though you have very good reason to know that they have solicitors in this state?

(p. 164) A. I have reason to know that there are solicitors within the state. I have no knowledge whatsoever that they belong to *Reader's Rigest.*

Q. You don't know that *Reader's Digest* has people—I'm not going to go further. We know that you know there's solicitors. We know that *Reader's Digest* is in the state. You know it's a widespread practice, and you know you subscribe to *Reader's Digest,* but knowing those facts, you went no further. You just ignored all of those facts and didn't do anything about it?

A. I did not go any further, that's correct.

Q. All right. So *Texas Monthly* has to do this. *Reader's Digest* doesn't, and you've done nothing else to find out anything about *Reader's Digest's* obligations; correct?

A. That's correct.

Q. All right. Now, there's a second problem in this case. It's consumers pay tax themselves. That's their obligation, too?

A. That's correct.

Q. Okay, and I believe on deposition (p. 165) you told me that that was a widespread practice to ignore that obligation?

A. I don't know how widespread it is. I know that I have ignored it.

Q. Okay, and you believe it's generally ignored by most people in this state?

A. Yes, I do. I believe that.

THE COURT: I think I can take judicial knowledge of that now.

QUESTIONS BY MR. GEORGE:

Q. Okay, and this is the second—these are two different obligations, and this one is just as much the law as that one?

A. Yes, sir.

Q. Okay. Now, in connection with this issue, you have told us the Comptroller has a system to collect money without any forms to be processed—

A. That's correct.

Q. —without any returns to be processed, without anything else, doesn't it?

A. Without any of those items being done by consumers, that's correct—without the forms being filled out or anything by consumers—

Q. Well—

(p. 166) A. —that's correct.

Q. —bring you money?

A. They just hand it to us, and we give them a receipt.

Q. And that's net money. I mean, there's no cost of administration then, is there?

A. At that point, no, sir, but getting the money on the system there's a cost.

Q. You have to put it in the bank?

A. Among other things.

Q. Okay, but in connection with this system, the only thing you've done to inform people of the obligation or to encourage voluntary compliance—the only thing that is directed to people who don't hold permits that are not in business is to pass out a brochure with one sentence in it at the State Fair?

A. Well, if you discount the brochure on use tax that they have available to them and the rule on use that is available to anybody who needs it.

Q. Yes, ma'am. Let's look at the brochure on use tax, which I have lost. What did I do with it? There it is. Now, let's look at that.

(p. 167) MR. GEORGE: May I approach this witness?

QUESTIONS BY MR. GEORGE:

Q. There's an example about what—how the use tax applies, and bunches of examples, aren't there, in this—several examples in this exhibit?

A. Yes, sir.

Q. The first one has, example, Mary Doe Company orders a printing press. That's a business example, is it not?

A. Yes, it is.

Q. The next example is B&R Construction Company orders cypress paneling from Florida. That's a business example, isn't it?

A. Yes, it is.

Q. Example three, Doe Company in Austin sends its answering machine to be repaired in Ohio. That's a business example, isn't it?

A. Yes, it is.

Q. The third one is a Houston repairman orders equipment from New York. That's a business example, isn't it?

A. Yes, sir, it is.

Q. You have—the next example is a (p. 168) California office furniture company has a liquidation sale in November. A Texas company buys 20 desks. That's a business example, as well, isn't it?

A. Yes, sir, that's correct.

Q. The next one is Sam Feather, a direct payment permit holder, buys 200 cases of motor oil from a Texas seller and issues a valid direct pay exemption. That's a business example, too, isn't it?

A. Yes, that's the example of a business that pays tax directly, yes, sir.

Q. And Creighton Corporation of Texas sells three forklifts to a subsidiary in Texas, and that's another business example?

A. That's correct.

Q. And finally you have Farmer Brown orders a tractor. Now, that's kind of a business example, but in that example you tell him no use tax is due because there's an exemption?

A. Because there's an exemption, yes, sir.

Q. And of all of the examples that if a consumer gets this brochure, there's not one (p. 169) example—one word about regular consumers' obligations to pay the tax, is there?

A. That's correct.

Q. And there was no additional cost, would there have been, to put in an example about you go to Bloomingdales and you have them send you things and you can have—and you owe use tax on that? That could have been included?

A. Yes, it could.

Q. And you chose not to?

A. Yes, sir, that's correct.

Q. Now, the statute book I handed you before gets distributed to people, does it not?

A. Anyone that asks for it, yes, sir.

Q. And this contains the exemption for religious publications, does it not—religious periodicals?

A. Yes, sir, that's correct.

Q. And it is used to inform people that if a periodical contains holy or teachings sacred to the faith and published by a faith it's exempt from tax?

A. That's correct.

Q. And your job is to advise people about that exemption?

(p. 170) A. Anyone that asks us, yes, sir.

Q. And you have done that?

A. Yes, sir.

Q. And you know, as you testified earlier, that those publications exist?

A. Yes, sir.

Q. And you go about applying that exemption under the terms it's written, do you not?

A. Yes, sir.

Q. And you have the obligation, at least under the statute, to determine whether the teachings are or are not sacred to the faith and whether they are not—whether the content of those—that magazine, that periodical comes within the exemption—whether what the words are come within the exemption. That's what the exemption says, and it's your obligation to inform people about that?

A. That's what the exemption says, yes, sir.

MR. GEORGE: Pass the witness.

REDIRECT EXAMINATION

(p. 171) QUESTIONS BY M. MENDEZ:

Q. Well, Ms. Hutcheson, do you have a budget to publish these brochures? Is there money appropriated by the State Legislature to provide these kinds of documents?

A. Yes, sir, there is.

Q. And is there a reason why you might make brochures for a specific area, as opposed to just a general brochure?

A. Well, we direct them at where we will probably get the most money.

Q. Okay, and there's a brochure on boats, I think, that I handed you? I'm not sure.

A. Yes, sir, there was.

Q. Let me see. Where's the rest of them? What is that entitled?

A. That's a brochure entitled Boat Dealers and Buyers.

Q. Okay, and is there any reference in there about a user of a boat that might bring that boat from out of state and use it in this state?

A. There's a section entitled the Use Tax, and it talks about the customer owing a use (p. 172) tax on a boat that he or she brings into Texas.

Q. Okay, and does it require them to remit taxes on it?

A. Yes.

Q. Okay. Now, is—from your experience in the Tax Administration Division, is that an item that might be a large ticket item that might generate the types of tax dollars that you're looking to collect?

A. Yes, sir, it is plus we get—we have specific information about boats so that it's a lot easier to get the

information and the people about boats than it is the public in general.

MR. MENDEZ: Pass the witness.

RECROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. One final question. Ms. Hutcheson, on the boat example, you have to register a boat to get a license—a little sticker to put on the boat, don't you, to pay a fee to the wildlife—

A. I think, yes, Texas Parks and—

(p. 173) Q. And you can't get a sticker, unless you show your sales and use tax has been paid?

A. That's correct.

Q. And you enforce that obligation?

A. Plus we also get information from—I think it's the Coast Guard on people who are bringing boats into Texas.

Q. So that if they ever come in and register it, they have to pay that use and sales tax or show their receipt to get the certificate?

A. Well, we get the people who bring boats in, whether or not they register them, but we also get it in the situations where they're registered with the Parks and Wildlife.

Q. But you make no similar effort for magazines—made no effort to inform people who read magazines, put signs up at the library, anything?

A. We don't get any lists from any particular division or agency about people who are coming in with magazines like we do boats and aircraft.

Q. Or who live in Lockhart, Texas and take *Reader's Digest* and don't pay the tax?

A. That's correct.

(p. 174) MR. GEORGE: Pass the witness.

MR. MENDEZ: No further questions.

THE COURT: You may step down.

MR. MENDEZ: Your Honor, we'll call Mr. Mike Shoemate.

THE COURT: I'm getting a sense—I've heard quite a bit now, and I recognize you're still putting on your case, Counsel, but I haven't discovered any real disputed facts —maybe some interpretations that the Court is going to be called on to—with reference to some of these facts. Is there any way we could—

MR. MENDEZ: No, sir, Your Honor.

THE COURT: —speed this up a little bit?

MR. MENDEZ: I'd like to be able to stipulate to the fact that the Comptroller, you know, has a business reason—a cost effectiveness reason for not—for not collecting the taxes from certain people, but (p. 175) what—I don't think that's possible, and essentially what I'm trying to show is that he has a finite set of resources, and he's trying to make a reasonable effort to collect taxes in the most economical way he can, and that if you start doing the things that they're asking us to do, it becomes kind

of absurd, and I think that's been pointed out, but the case law that we've pointed out—the Alabama case that's there and, of course, *National Geographics* seem to require some sort of proof, and I'm willing to tell the Court everything that my client does to collect taxes and why they pick on one person and not on another from an economic standpoint, a business standpoint, just the same way as the plaintiffs have said they're not going to collect the tax and they'll eat it—because it's a business decision, and I think that's relevant testimony under that case law.

THE COURT: All right.

MR. MENDEZ: If we can have him sworn?

MICHAEL SHOEMATE

was called as a witness and, having been (p. 176) previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Could you please state your name and address for the record?

A. My name is Michael Shoemate. I reside at No. 1, Pettytown Road, Red Rock, Texas.

Q. Okay, sir, and how are you employed?

A. I'm employed with the State Comptroller's office.

Q. And how long have you been with the Comptroller's office?

A. Fifteen years.

Q. Okay, and could you tell the Court what your position is currently with the Comptroller's office?

A. I'm area manager for the Comptroller.

Q. Okay, and what area—in what division do you work, sir?

A. I work in Field Operations Enforcement Division.

Q. Okay, and what area of the state is your particular area?

(p. 177) A. I'm responsible for the eastern one-third of the state.

Q. Okay, and what did you do prior to being an area manager?

A. I was a field office manager in enforcement in Austin.

Q. And how long were you a manager here in Austin?

A. For eight years.

Q. Okay, and prior to that time, were you employed with the Comptroller?

A. Yes, I was an enforcement officer for seven years in Houston.

Q. Okay, and did you manage another office in Texas as a—

A. I managed for one year in the Bryan field office.

Q. Okay, sir, and what did you do before you went to work for the Comptroller's office?

A. I worked for a sales and collection organization in Houston.

Q. Okay, and do you have any college education?

A. I attended the University of Houston.

(p. 178) Q. Okay, and could you tell the Court what types of courses you might have taken there?

A. I majored in accounting and business.

Q. Okay, and did you do this in connection with your employment with the—

A. Yes.

Q. Now, have you attended—well, you're in a management position now. Have you attended any management seminars with the Comptroller's office?

A. Yes, we have provided to us inhouse management training. We also have provided—management training provided by other universities.

Q. Okay, and are you familiar with the taxes, or are you kept up to date with the technical side of the taxes?

A. Yes, our training also includes technical.

Q. Okay. Now, sir, could you explain to the Court what the Field Operations Enforcement Division does?

A. Well, it's our responsibility to ensure that the identifiable segment that's permitted for the State are currently paying and (p. 179) filing taxes.

Q. Okay, and does this also include finding persons that may not have permits at this time?

A. In some cases it does. We conduct various tasks to identify people that may be responsible to owe tax but

are not identifiable through our taxpayer list within our computer.

Q. Okay, sir, and are you given collection assignments by the other divisions of the Comptroller's office to go collect taxes?

A. Yes, sir, we are.

Q. Could you give the Court an idea of how many collection assignments you might get in a year, let's say?

A. Well, for example, the first three months of the fiscal year we generated a hundred and thirteen thousand collection assignments to the field.

Q. Okay, and do you do other types of assignments for the Comptroller's office?

A. We do investigations generated by the different tax divisions covering cigarette tax or fuel smuggling things of that nature.

Q. How many taxes do you administer in (p. 180) your enforcement group?

A. Predominantly 13.

Q. There are other taxes but they—

A. Yes, sir.

Q. —might not be that important? Now, do you provide any taxpayer information to the citizens of the State of Texas?

A. Yes, sir, we do through our field offices. Is that—

Q. Well, what kinds of things do you have available at the field offices that someone might get through—well, from the Comptroller's office?

A. Essentially we have all information that's made available to the public from the statutes to newsletters that are issued by the agency, to various pamphlets or brochures that are made available to the public.

Q. Okay, sir, and about how many persons work for your division?

A. Approximately 428.

Q. Okay, and how many offices do you have in the State of Texas?

A. We have 41 offices throughout Texas, and we have a phones collection bank here in (p. 181) Austin.

Q. Okay. Do you try to locate these offices in large metropolitan areas or what—

A. The majority of our offices are located in the metro SMSAs.

Q. Okay, and is there a specific reason for doing this?

A. Generally it's because of the volume of assignments created from those locations.

Q. Okay, and could you explain for the Court what types of programs you have in place to carry out your job —your functions?

A. Well, essentially our entire program is based on voluntary compliance, but through our computer system we identify those that don't file and pay their tax returns. We—as mentioned earlier, we conduct roadblocks to identify fuels violations, a possibility of detecting audit leads from out of state purchases. We do canvassing projects,

both physical and phone, and I'm sure there's some others that I don't—you know—

Q. Could you describe for the Court what kind of canvassing activities you conducted after the 1984 tax changes?

(p. 182) A. To the best of my memory we conducted a canvass prior to the change.

Q. What did that consist of? What industries might you have contacted during the course of that?

A. Everyone that was identified to us by our Tax Administration Division that would fall within the guidelines of the new legislation.

Q. Okay, sir, and just to put it in perspective, what were you doing at that time?

A. I was a field office manager in Austin.

MR. MENDEZ: Okay. At this point, Your Honor, I want to mark another exhibit.

(At this time an instrument was marked as Defendants' Exhibit No. 12 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. I'll have you identify this document, sir. Is that a document that you received in your office while being an Austin field manager?

A. Yes, sir, this is the style of information transmittal document to all offices.

(p. 183) Q. Okay, and could you give us the date of that document?

A. It's August 3rd, 1984.

Q. Okay, and who is it from?

A. At that time it was from Robert Storey, our director.

Q. Okay, and is this a document that you used in conducting your business?

A. Yes, this is an informational memo to tell us, you know, priorities or what we could be doing, updates on information. It's a general memo, and what it has in it—let me look through it right quick. Okay. This contains the original memo submitted from Tax Administration Division identifying the different types of business codes that were effected under the new legislation.

MR. MENDEX: Okay, sir. I'd like to offer Defendants' Exhibit No. 12.

MR. GEORGE: I'm not sure what's relevant of it.

MR. MENDEZ: I'm going to ask him some questions as to what he did with it after he got it.

MR. GEORGE: I don't have (p. 184) any objection. May I add to the Court that if the purpose of this examination is to show that the Comptroller has lots of responsibilities in the budget and needs—and has people that work hard to try to collect taxes generally, I can stipulate that. If that's the purpose—

MR. MENDEZ: That's not the purpose. The purpose is to show that we spend the appropriate amount of time with each specific and each effort that we—I mean, each type of situation that we can and that it amounts to

such a level of activity that we haven't discriminated in an unconstitutional manner against any specific group from an as applied basis.

QUESTIONS BY MR. MENDEZ:

Q. I'll hand you back this document, Mr. Shoemate, so that we can continue to discuss it. Did you conduct a canvass of your area of Austin pursuant to the information that you obtained from this document?

A. Yes, sir, we did. In fact, it was statewide, to the best of my knowledge.

Q. Okay, sir, could you identify—could you turn to the last page of that document? (p. 185) What's contained on that page?

A. Types of businesses identified by Standard Industrial Code.

Q. Could you give us the last three or four items listed in that?

A. Book stores, local newspapers, local magazines.

Q. Okay. Now, these are items that were identified to you by your superiors as being affected by the new tax changes; is that correct?

A. Yes, sir, by Tax Administration Division.

Q. Okay. Did you do anything to attempt to contact these people and let them know of their tax liability?

A. Yes, sir, we conducted a canvass of all of the identifiable segment in the city.

Q. Okay. Could you explain for the Court what you and your employees did once they got this memo and how you proceeded to inform all of the persons on that list?

A. Well, first we had to identify who, by name and association, would fall into the affected SIC codes—like a laundry. We would (p. 186) go into the phone book, identify all of the laundries in town and contact them to be sure that they were either/or permitted or non-permitted and be sure that they understood the new tax law change, provide whatever written information we had at that time.

Q. Okay, and could you describe for the Court how you divide up your part of the—of the State so that your employees can work it?

A. Well, it's regional by office. Simply stated, if I could use the situation of Austin, you have a staff of enforcement officers, and you divide up on an equal basis by zip code basis so that they're in an assigned area, and they're responsible for what takes place within that area.

Q. Okay, sir. To the best of your knowledge or from your experiences with that memo, do you know if the magazine publishers that were located in your area were contacted?

A. To the best of my knowledge, they would have been.

Q. Okay, and each field officer, each representative and his section of the State would have had to locate and inform the people (p. 187) on that list or would have had to try to locate every person?

A. Yes, sir, that was the overall objective—would be to get the information out to the public of the new change.

Q. When did you conduct your canvass?

A. During the months of August and September of 1984.

Q. Was it completed by that time?

A. I'm going to assume it was, yeah.

Q. Now, did you have to go back and recanvass later on?

A. We had a follow-up project completed, I believe, around November of '84 just to do a sample survey to see our effectiveness, to possibly detect our percentage of error of someone we might have missed. We've also—since November of '85, we redid another survey by phone into the various industries to determine the percentage of error again.

Q. Okay, sir. Now, what—do you have any other audit programs that might be in place in the enforcement Division?

A. I don't understand your question.

Q. Well, do you attempt to canvass—I (p. 188) mean, to audit or to check, you know, your tax base for compliance to make sure that everybody is filing or not filing during the course of the year?

A. Well, when you say the word audit, no, we don't audit within my division. That's another division, but we work generally just from what's identified to us from the

computer initially. Then we do some types of investigations to identify tax abuse or tax evasion.

Q. Do you maintain a phone bank in your headquarters to contact some of these individuals?

A. We have a phone bank located in Austin.

Q. Okay, and that's different than the tax assistance phone bank; is that correct?

A. Yes, sir, this is a collections phone bank only.

Q. Now, sir, could you explain some of the collection actions that you might take against a person just briefly, if they didn't pay?

A. First of all, like I mentioned (p. 189) earlier, it's identified to us. If we're using the example of a tax return if someone does not file or does not pay, then that assignment is generated depending on category either to our phone bank or to our field offices. From there, assuming that it goes to the field, the field enforcement officer makes contact with the party, obtains the necessary information, either resolves the account, or it could continue on into statute areas, such as freeze and levy or—

Q. Okay, sir, and do you divide up the accounts that you give the phone bank, as opposed to the ones you give the individuals that are out on the streets?

A. Yes, sir, we have to.

Q. Do you do that on the basis of how much they're worth?

A. Everything that goes to the phone bank is less than $400. Everything that goes to the field is over $400.

Q. Now, I want to give the Court an idea of what kind of resources you have to work with. Could you tell them how many people you have working for you?

A. Statewide or just my area?

(p. 190) Q. Statewide.

A. We have approximately 400 people in the field.

Q. Okay, and are these the only enforcement officers that the Comptroller's office has?

A. No, that includes everyone. We have about 200 and—approximately 250 enforcement officers.

Q. Okay, and are these at various levels of experience or how are these—

A. Yes, sir, they're graded in levels of one to four.

Q. Okay. Do you think that you have a well qualified staff of enforcement officers?

A. Yes, sir, we have 208 senior enforcement officers.

Q. Okay. Could you give the Court an idea of what types of people you might hire, what kinds of qualifications they'd need to be an enforcement officer?

A. Generally the posting that we issue out for employment requires or prefers a college degree, four years related experience—you know, other general items.

(p. 191) Q. Do you train those individuals?

A. Yes, sir.

Q. Okay. I guess we shouldn't get into everything that you are teaching, but I gather that they learn the statutes; is that correct?

A. Yes, sir, that's one of the first things they go through.

Q. Okay, and in order to progress and become a high level enforcement officer, do they have to exhibit any knowledge of the statutes or the various taxes?

A. Yes, sir, they do. Generally an entry level enforcement officer for approximately the first year, depending on their own capabilities, deals with sales tax only, and they can advance, so to speak, by the level of other—their competence in other taxes.

Q. Is each one of these individuals—these EOs in charge of his own area and responsible for contacting people in that area?

A. After their first six months they're assigned an area essentially independent with over—someone overseeing what their activities are, such as another senior EO.

Q. If they fail to properly communicate (p. 192) policy to taxpayers, is there a mechanism by which you can check them and make sure to correct situations like that?

A. Well, we do office observations on that person while they're in the office in answering taxability questions. We send other officers out with them to see how they're conducting their business out in their area. The managers ride with those people to see how they're doing their business, yes.

Q. Okay, sir, and if somebody were to—if they were to notice a new business go up in their part of the—in their sector and it turned out to be a publishing business, would they go in there and contact those people and find

out what kind of information they had—what kind of business they were doing?

A. Well, I believe so. I don't think it would matter what kind of new business it was. It's—in collections training you teach psychology and tactic, and it's also like an unwritten rule—your awareness of where you are working. You realize who's going out of business, who's going into business because you're there each day, and so by standard they (p. 193) would go in and, "Are you permitted for sales tax or are you not?"

Q. Okay, and if, let's say, a magazine publisher from another state went into Dallas—a certain segment of Dallas and he opened up an advertising office, is that something that an EO might locate in a phone book or some other record?

A. It's possible, yes.

Q. Is he responsible for checking all of the businesses in his sector?

A. Yes, sir.

Q. Okay. What kind of a case load does one of these enforcement officers carry at any one time?

A. Probably about 250.

Q. That's individual assignments either field or collection?

A. Individual accounts.

Q. Okay, sir, and is he under some pressure to get these things out, or how does he work, or what is his motivation for getting his work done?

A. I don't know if you'd term it pressure or not, but we measure performance (p. 194) level on their ability to complete the assignment within a given period and whether or not they can collect that assignment in total.

Q. Okay, sir. What types of information or resources do you have available in your field offices so that these EOs might be able to know what's going on in their part of the community—in their part of the state?

A. Are you referring to our publications?

Q. Yes, or just in general what does the Comptroller subscribe to or use, or what do EOs use to make themselves aware of what's going on in their part of the—

A. Well, we have all of the tax statutes available, as I mentioned earlier. We have all of the brochures. We have a microfiche indexing system that gives all court decisions, all hearings decisions on audits. I don't know the term, but it's a letter where somebody may have written into the agency, "This is my situation. Is it taxable or is it not?"

Q. So they have a—

A. Various other sources.

Q. So they have resources on how to (p. 195) interpret policy?

A. To the best of their ability. We have as a—in tax administration we have a section that if that person is unable to obtain the answer needed that they can call upon as, so to speak, the special materials experts.

Q. Okay, sir, and they might get a policy decision from there, if they're not familiar with the area themselves; is that correct?

A. They could.

Q. Okay. Now, what would an EO use to find out what kind of business is going on in his part of the community—what kind of changes are going on?

A. Personal knowledge, trade magazines, these little sale papers to see what's going on in their area, TV. You know, you see someone advertising, doing this or selling this or what have you.

Q. Okay, and well, let me ask this: In your experience as an enforcement officer or as—well, let me go on. Could you tell the Court what kind of a budget you have to operate with on a yearly basis?

(p. 196) A. Approximately 14 million.

Q. And that's each year you have 14 million dollars to use for your resources?

A. I wouldn't say each year. I just know that that's what it is this year.

Q. Okay, and do you keep track of how much money you collect on a yearly basis in terms of—

A. Yes, sir.

Q. Okay. What would that be termed? What kind of—what do you call your collections?

A. We expect to collect both current and delinquent dollars in approximately 200 million this fiscal year.

Q. And do you keep records of how many contacts you might have with the public during any year?

A. Yes, sir.

Q. Okay, and how many do you usually have during a year?

A. I don't know.

Q. Okay, sir. In the course of your employment in the management of this area, are you aware of any program or any computation that (p. 197) the agency has done with respect to how much it costs an EO to complete a transaction, you know, in terms of dividing the amount of money you collect by the volume of transactions?

A. We haven't—you mean what does it cost us to call on someone else?

Q. Yes, sir.

A. Yes, sir, we have one. It shows that like almost a year and a half ago it was $15 some-odd cents—

Q. Okay, sir.

A. —to make that contact.

Q. So it costs over $15 for each contact, each field assignment? Is that what you're—

A. No, it was based on whether it would be considering all overhead and the number of assignments—

Q. Okay, sir.

A. —whether it be by telephone or the taxpayer came into the office or we had to send an agent out, which is the most expensive, but the overall average was 15 something.

Q. So you took the total budget that you have, and then you divided by the number of (p. 198) contacts that you had in that particular year, and you arrived at a number that's in excess of $15 per transaction?

A. That may be correct. I did not work on the formula but—

Q. Do you use this figure in deciding whether or not to send people out?

A. Yes, unless it's a special request type of field investigation.

Q. Okay, sir. So if somebody in tax administration or in executive administration tells you to go check on—investigate some situation, you'll go do it?

A. Yes, sir.

Q. And that's your job; right?

A. Yes, sir.

Q. Can you give the Court an idea of what time you spend, let's say, on collection activities versus detecting new taxpayers?

A. We spend about 60 percent of our time on collections, which includes everything—investigations of all sorts. Probably about—the remainder is spent with taxpayer services where people are actually coming to our offices.

Q. Okay, sir, and during the (p. 199) depositions in this case there was an individual, Mr. Dale Craymer—do you know Mr. Dale Craymer?

A. No, sir.

Q. Okay. He's an employee of the Comptroller's office who was deposed and he—it turns out he reads a lot of magazines, and I added up the amount of the subscriptions in his magazines, and it come out to—let's say, from a hypothetical standpoint, to about $281, and I'm asking this in a hypothetical standpoint. Do you know offhand more or less how much tax that would accrue here in Austin, because he lives here in Austin, in this hypothetical from $281?

MR. GEORGE: That's an extremely leading question. I'll object to it.

THE COURT: I sustain the objection.

QUESTIONS BY MR. MENDEZ:

Q. Mr. Shoemate, if I told you that somebody owed—I mean, had purchased $281 worth—a consumer had purchased $281 worth of products and was using them in Texas, do you have an idea how much tax that would give rise to?

(p. 200) A. Not right off the top of my head.

Q. Okay. If you compute that, would it be—well, let's say that it was $300. Let's just round it off, and you're in Austin, and it's a little bit over—

A. Approximately $18.

Q. Okay. Now, if I called you up and I was—let's say I was in tax administration, and I gave you that kind of an audit lead. Would you send somebody out to go check on Dale Craymer or anybody else because they owed $18?

A. Probably not.

Q. Okay. So there would have to be some extenuating circumstance or some other reason for going out there than just to collect, you know, $18?

A. Yes, sir, when we use the $15, we have to look at—each contact that we make generates about $900. So if you're trying to say there's a trade off there, yes, sir, I'd have to make a decision whether to send that person out for 900 or 18.

Q. Okay, sir, and there's been some testimony elicited here as to the Comptroller having to collect taxes from all consumers and (p. 201) from every household or every person that purchases and uses items outside the State of Texas and brings them for use—into use in the State of Texas. What—could you explain—if I'm a household and I've incurred a use tax liability for my camping equipment that I purchased from out of state, what types of collection actions would you take against me in the normal course of your business?

A. Oh, we would attempt to contact you. If you're the normal household, you're not at home during the day. So our next step would be to estimate a tax return on you. You would get a notice of demand for payment. If you failed to pay it, we would go to the extent possibly to freeze or levy your bank account. I mean, it depends on the individual circumstances but—

Q. How could I prove to you that I—you know, that the company I purchased it from had remitted the tax for me?

A. You could produce the sales ticket.

Q. Okay, and if I'd lost that, would you take my word for it?

A. Well, I assume we could probably verify it through the seller.

(p. 202) Q. Assuming I wouldn't provide you—I filed a return and didn't send you any money, would that be a return that you would send a field assignment out on?

A. Repeat that.

Q. If I filed a return with the Comptroller's office and I put zero tax or I put down I purchased a hundred dollars' worth of goods from out of state and I'm not remitting any tax, would that generate a collection action?

A. Yes, sir, but not to the field.

Q. Okay. Well, it's been your testimony, sir, that you file liens and you freeze bank accounts of people that have permits now. Now, would it be—would you use these—would you have to use these same tactics against households in the State of Texas in order to be fair in what you are doing?

A. Possibly if there was no other way to resolve the situation.

Q. Now, sir, have you become aware of, through your job as an area manager or through your job as an office manager in Austin—of any plan by the Comptroller to leave out any out of state publishers that might have nexus in the (p. 203) State of Texas—to just not deal with them?

A. I'm not aware of any.

Q. Okay, sir, and if somebody had said, "Don't enforce the sales or use tax against a particular individual,"

would that have come to the knowledge of the Enforcement Division?

A. I would assume it would, if we were specifically told not to do something.

Q. Would you—the employees that you have—are they instructed to collect and to permit anyone that has use or—sales or use tax liabilities that they come in contact with?

A. If we're able to identify that they have made purchases. I mean, we do several things that does identify to us, such as—an example, Parks and Wildlife submits us a list of boat registrations from out of state, and we contact the owners and set the use tax up on that, yes.

Q. Okay, sir, and if somebody comes up to you and says, "I just brought in some clothes from New York and I didn't pay a sales"—or "I just had some clothes shipped from New York to me here, and I didn't pay a New York sales tax," would you take their money, if they gave it to (p. 204) you?

A. If they walked in the office, we'd take their money.

MR. MENDEZ: Pass the witness.

CROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Could I see that exhibit you have in your hand there, Mr. Shoemate? By the way, are you related to this lady who's been with us through our trial, Mona Shoemate?

A. Yes, sir.

Q. Congratulations. Now, I believe you made a reference to a canvass that you're—somebody was supposed to do under your supervision of various organizations after the passage of the taxes in the summer of '84?

A. Yes, sir.

Q. Okay. You went—did somebody go to all of the kind of businesses on this list including amusement parks, antique shows, drag strips, golf courses, pool halls, hot tubs, concessions?

A. Well, some of the industries—and (p. 205) I'm not familiar with exact which ones—were notified through their associations.

Q. Which ones do you know from your own personal knowledge that canvassers went to? Can you swear that somebody went to anywhere?

A. Sure.

Q. Who?

A. We went to all of the above on that list that we could identify.

Q. Did you—people—did somebody—you said that somebody went to see the local magazines, to the best of your knowledge?

A. To the best of my knowledge.

Q. Do you know—

A. Me, personally, did not go.

Q. Did you go with anybody?

A. Not during that time.

Q. All right. Did anybody send you a report that they went?

A. They keep daily activity records of where they went.

Q. Can you tell the Court of seeing any daily activity report of anybody who went to see a local magazine?

A. At this time, no, sir, I cannot.

(p. 206) Q. You don't remember any of them, do you?

A. Well, I've—you know—

Q. Okay. Let me ask you do you take any magazines?

A. One.

Q. What's that?

A. *The Horseman.*

Q. *The American Horseman?*

A. No, sir, just *The Horseman.*

Q. *The Horseman?* Is that published in state?

A. Yes, sir, it is.

Q. Do you know whether its taxes are paid?

A. To the best of my knowledge, it is.

Q. Do you pay any on your bill?

A. I don't know. I haven't checked the bill.

Q. Okay. You don't know? Let me ask you do you ever have people call on you to sell you magazine subscriptions?

A. No, sir.

Q. Do you have any kids?

A. No, sir.

(p. 207) Q. Do you know whether or not there is a practice of people having solicitors in the state going door to door and soliciting magazine orders?

A. Yes, sir.

Q. There are?

A. Well—

Q. Do you know whether those solicitors are soliciting magazine orders for out of state publishers?

A. I'm not aware whether in all cases it is for out of state publishers or—

Q. Do you know—

A. —in state.

Q. Excuse me.

A. Pardon me?

Q. I didn't mean to interrupt you. Have you finished?

A. Yes, sir.

Q. Okay. Do they solicit from—do you know that they do solicit for some out of state publishers?

A. I don't know that for a fact, no, sir.

Q. You believe that to be the case?

(p. 208) A. Well, when I lived in the city most often if someone came to your door, they were representing The University or a local PTA or—

Q. They had a whole list of magazines, though?

A. Well, they may have. I never subscribed to one. I never asked.

Q. But they called on you?

A. Yeah, they knocked on my door.

Q. Yes, sir, and they were—you were familiar with the sales tax statutes, aren't you?

A. Somewhat, yes, sir.

Q. Yes, sir, and you know that if someone—a publisher of *Reader's Digest,* for example, or *Sports Afield* or any other publication has people in this state taking orders for it, it's doing business in this state, don't you?

A. Yes, sir.

Q. And you knew that when you were in the Enforcement Division living in the city?

A. Yes, sir, but—

Q. And people called on you?

A. Yes, sir, that's true.

Q. And you didn't do anything to check (p. 209) to see whether those people were paying taxes, and you haven't done anything to check to see if they were paying taxes to this day, have you?

A. Well, if it was an organization sponsored through The University or through one of the local schools, we

already know from experience or we can go and check the computer that the local PTA is permitted.

Q. Mr. Shoemate, I asked you did you go and check to see whether the publisher who had representatives taking orders in this state and thus doing business in this state was paying taxes on subscriptions sold in this state?

A. No, sir, we always checked back to see who the organization was selling.

Q. I understand. So you haven't done one thing to collect—to take any effort to enforce the tax against any out of state publisher, have you?

A. To answer your specific question, no.

Q. And in the—what—15 years—well, it's been on the books since October 1984. Nothing has been done, has it, to your knowledge, in the eastern third of the State where you've been working?

(p. 210) A. Not to my knowledge.

Q. In all of these years ever since that period of time, October 2nd, 1984?

A. To my personal knowledge, I don't know.

Q. You don't know of anything?

A. No, sir.

Q. All right, but you were directed to call on local magazines?

A. That was the requirement in the canvassing project, yes, sir.

Q. Now, was there any—has the requirement to canvass ever been rescinded?

A. No, sir, we have an ongoing process where we contact 25 percent of the tax base each year.

Q. Has anybody in your office ever been told not to canvass--not to go to any particular kind of organizations?

A. Not that I'm aware of.

Q. All right. Now, in connection with the consumers that owe taxes, tell the Court about any action you've ever taken against any consumer to collect taxes—enforce taxes against a non-permitted, non-use tax permitted, (p. 211) non-business consumer?

A. Well, the example I used on the boat purchases.

Q. The boat purchases? Anything else?

A. We do it on plane purchases.

Q. Airplane purchases? How about any magazine purchases?

A. Not that I'm aware of on specifically magazine purchases.

Q. How about people buying clothing, in fact, if that's the case?

A. Well, generally that is the—the hardest to identify, if anyone buys anything and brings it in out of state, unless we have a traceable record, such as the boat or airplane industry.

Q. Do you have any—do you make any effort to identify people who have solicitors in the state?

A. Yes, I mean, we are aware of where—I don't know the company's name, but they'll bring in people from out of state to sell paintings door to door and—

Q. What about people who—

A. —we try to—try to identify who (p. 212) they are when we see them operating within the state, yes.

Q. Have you ever had anybody do anything on magazines that have advertising sales offices in the state?

A. Not that I'm aware of.

Q. You mention that you might—that's possible that somebody could do that—that one of your enforcement persons could look in the Dallas phone book and see—or in the Houston phone book and see if *Time, Newsweek* or some other company had an office in that city and take enforcement actions?

A. Sure.

Q. Haven't ever done it, have you?

A. I can't say that they have or have not, if they could identify in the phone book.

Q. You can only tell the Court, Mr. Shoemate, what you know, and I ask you do you know if they have done it?

A. Me, personally, I don't know if they have or have not done it.

Q. You can't say that they have?

A. I can't say that they have not.

Q. How long have you known about this (p. 213) lawsuit?

A. Probably a couple of months or whatever. I don't really know how long.

Q. During that period of time have you simply picked up the phone back [sic] and looked in Dallas and Houston and seen if they have any sales offices and done anything about it?

A. No, sir, I have not looked in the phone book.

Q. And that's your responsibility to enforce this statute?

A. Yes, sir, it is.

Q. And is Dallas or Houston in the eastern third?

A. Houston is, yes, sir.

Q. But you haven't done it?

A. No, sir, not since I've been in that position.

Q. That's been the last two or three months?

A. Just five months.

Q. Yes, sir, and during that period you have known about this lawsuit, and despite knowing about the lawsuit, you haven't done it, have you? Your wife has been involved in the (p. 214) lawsuit, at least to some extent?

A. Well, that's how I know about it.

Q. And despite that, you haven't done anything to do anything to try to enforce against out of state publishers?

A. Well, as I stated earlier, we try to do things that are cost effective for us, and we've identified three areas in the last five months that generated millions of dollars in revenue for the State—

Q. Mr. Shoemate—

A. —and you know, the year is not over yet. So—

Q. —you understand that—have you gotten any information about how many out of the state magazine sales are ordered in this state?

A. I'm not aware of how many there are.

Q. If they're—according—do you know Phyllis Coombes?

A. No, sir.

Q. Do you know if they're—if it was told or information was in the hands of the Comptroller that there were 290 million dollars' worth of sales of magazine subscriptions each year, would that be a significant sum of money (p. 215) to try to tax in Texas?

A. I would assume so.

Q. And nothing has been done; is that right?

A. Not at this time.

Q. Do you think you may get around to it?

A. Well, you know, it depends on how we plan the remainder of the year and what projects we go after.

Q. But you don't know about it yet?

A. Well, from the standpoint of when the tax became available, you know, we try to plan what we have case history on, so to speak.

Q. Do you know Glen Castlebury?

A. Yes, sir.

Q. Is he in a position to know the policy of the Comptroller's office regarding their intentions about collecting taxes?

A. Yes, sir, I would—or a general idea of our plans.

Q. Well, is he in a position to know the policy by senior management Comptroller better than you are?

A. Yes, sir.

(p. 216) MR. GEORGE: Pass the witness.

REDIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Well, Mr. Shoemate, at the risk of offending the plaintiffs, you mentioned that you'd been working on some specific projects that generate certain amounts of money. Does the upper level management tell you, "We want you to concentrate on a specific area or get a certain amount of money in"?

A. No, this is areas—we reorganized and we—a new director of field operations enforcement, and from there we decided these are projects that have been left undone that emit high volume tax and so we—in the first five months, we've gone after those projects.

Q. Well, sir, is it your objective to try to get the most money you can in the shortest amount of time that you can?

A. Sure.

Q. Now, sir, if somebody told you that there might be a magazine in Houston that has an office in Houston

and you hadn't received a (p. 217) field assignment from —from some other division that required you to go over there and chase after that person, do you have any time, or do you have the resources to allocate to go chase after somebody like that without knowing anything else about it?

A. Under the normal, no, because what time we have that we're not working on what we classify as a non-filer, we're usually doing other types of investigations in other taxes.

Q. Okay, sir, and how many people do you think you have working up in Houston?

A. About 87.

Q. Okay, and how many—what kind of case load on an average basis do those people carry?

A. Around 200 to 250.

Q. Okay, sir, and so are those generated by your other programs?

A. Yes, sir.

Q. Okay, sir, what would happen to your system is everytime somebody called up on the phone to your office and said, "There's somebody up in Houston that you've got to go check out" or "There's somebody over in El Paso that you (p. 218) have to go check out" without giving you any other information—what would happend to your system of organization if you went around carrying each one of those out on a daily basis?

A. Probably total disruption of the function.

Q. Okay, sir. How much money do you collect on each contact that you make with a taxpayer?

A. Approximately $900.

Q. And this is a system that you've had in place for how long—this system of enforcement? How long has the Enforcement Division existed?

A. Its total existence I don't know. The non-filer program identification by the computer has been ongoing since 1970, from the best of my knowledge.

Q. Okay, sir, and there was a question asked of you earlier about identifying whether or not some child that came to your door was permitted or not or whether he was soliciting for some out of state company. Do you check out your records to make sure that at least that group—that child is represented—has a (p. 219) permit?

A. Yeah.

MR. MENDEZ: No further questions.

THE COURT: Did you say yes?

THE WITNESS: Yes, sir.

RECROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. When is the last one you checked?

A. Well, I haven't had anybody call on me personally like that in almost five years.

Q. Before that did you ever—you, personally, ever check anybody?

A. Yes, sir, me, personally, I did. I mean, do you want an explanation, or do you want a yes or no?

Q. Did you—I just want to know if you checked anybody?

A. Sure. We used—I mean, just like the example I gave just because the nature of the job of being in enforcement—

Q. You went and checked the PTA one time to see if they had a sales tax permit?

(p. 220) A. Well, rather than harass the child, yes, we would go back and see if the PTA or the Boy Scout group itself was permitted for the collection and remittance of tax, and if they were and had been filing tax returns, then—

Q. You made no further investigation?

A. —you really make no further investigation. Those type organizations are set in what they do and how they —in most cases the school district will hold the ultimate permit for all of their operations. We also have other accounts we're verifying for nontax. So—

Q. I'm just trying to find out since October 2nd, 1984 have you checked out—can you swear here today that there has been a PTA checked out who's selling magazine suscriptions from out of state?

A. I cannot swear to that, no.

MR. GEORGE: Pass the witness.

FURTHER REDIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Shoemate, when you were doing (p. 221) this job out in the field, those types of examinations, those

types of verifications of PTA groups and others was expected of you; is that correct?

A. Yes, sir.

Q. Now, sir, you're a manager, and you're over all of the people in East Texas. Do you expect for them to carry out their job the same way that you used to do it?

A. Yes, sir.

Q. Okay, and from your understanding of how those people are trained and how you manage them, would you think that—would it be reasonable for us to assume that they contact the same type of people that you used to contact?

A. Yes, sir.

MR. MENDEZ: Pass the witness.

FURTHER RECROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Let me ask you one question. You were doing field work before 1977?

A. Yes, sir.

Q. And do you know whether or not (p. 222) magazine subscription sales were at least on the books subject to tax then?

A. Yes, sir, I believe they were.

Q. They were? And did you ever go out to an out of state—see somebody taking orders for out of state sales—for an out of state publisher and go and try to

find that out of state publisher and collect the taxes on that sale and all other sales that publisher had?

A. I personally can't recall as far back as 1977 whether I did, but I don't recall one, no.

Q. And the fact of the matter is that never happened in your experience, has it, during the period before '77 and after October 1984?

A. Where I personally have contacted a publisher?

Q. Yes, sir.

A. No, sir, I can't recall.

MR. GEORGE: Pass the witness.

MR. MENDEZ: No further questions.

THE COURT: Step down. (p. 223) We'll take a 20-minute recess.

(At this time a brief recess was taken, after which time the proceedings continued as follows:)

MR. MENDEZ: Your Honor, we call Wade Anderson.

WADE ANDERSON

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Would you state your name and address for the record, sir?

A. My name is Wade Anderson. My home address is 3505 Scenic Hills Drive, and my office address is 113 East 17th Street.

Q. Okay, sir, and by whom are you employed?

A. I'm employed by the Comptroller of Public Accounts.

Q. And what is your position with that office?

A. I'm general counsel.

(p. 224) Q. Okay, sir, and what are your duties as general counsel for the Comptroller's office?

A. Well, as general counsel I oversee many policy decisions that are made within our office. If legal questions arise, I'm usually involved both at a divisional level, and I will also be consulted by lawyers on the staff about general questions, as well as the administration. I deal with interstate taxation committees and associations and serve as Mr. Bullock's alternate representative on a few of those and just what legal problems come up I find myself addressing.

Q. Okay, sir, in your position as general counsel, have you become aware of any plan or scheme on the part of Comptroller or his staff to target a selected person or persons for selective enforcement of the sales and use tax?

A. Certainly not.

Q. Okay, sir, and have you had occasion to review any policy statement or rule or other document which specifically targets *Texas Monthly* or any other Texas publisher of magazines for enforcement of the sales and use tax while specifically excluding all of those (p. 225) out of state companies?

A. No.

Q. In your role as general counsel, have you had occasion to consider the tax treatment of companies that sell magazines or other types of tangible personal property to citizens of Texas but that may not have employees or a place of business here in the State of Texas?

A. Yes, I have.

Q. Okay, sir, and what's the Comptroller's position with respect to those types of companies that do not have contacts with the State of Texas?

A. Well, our basic position is that if there are no contacts that we do not have a right to tax them—that there's not constitutional nexus.

Q. Okay, sir, and could you give the Court an example of somebody that you clearly do not think has nexus with the State of Texas?

A. All right. Well, for instance, if you had a company that was advertising in national media—maybe 1-800 toll lines made sales to Texas citizens by means of this (p. 226) advertising and delivered their products, say, through the U.S. mail, we would say that did not—that company did not have nexus, and we would not be able to tax them.

Q. Okay, sir, and have you become familiar, in your position as general counsel, with the types of problems and situations that occur with the different levels of contact of companies with the various states?

A. Well, not all of them, of course, but many of them.

Q. Okay, and are those problems that are considered by the Comptroller of Public Accounts of the State of Texas in addressing these types of issues?

A. Well, when you start talking about, you know, taxation of these companies that have very limited nexus or no nexus, you know, the problems that surround those are discussed with other State tax administrators, and I —you know, we are aware of them, and I have—I have personally talked to a number of tax administrators about them. Maybe I haven't answered your question there.

Q. Well, that's sort of the area I was (p. 227) getting into. What steps has the Comptroller of Public Accounts taken to address the out of state sellers issue?

A. Well, we've really addressed it in two different ways. The most direct way is through our cooperation with the MTC in using them to address these mail-order type businesses, nexus being a very delicate and, you now [sic], close question in many instances. They are very well qualified to deal with that. The second area is that we have tried to encourage the Congress of the United States to pass legislation which would clearly allow us to tax these types or require—actually to require the sellers to collect the use tax for us.

Q. Okay, sir, and in the course of your business or in the course of the Comptroller's business, has he had occasion to conduct a study to determine the amount of revenues that might be—the potential revenues that might be out there from these mail-order type interstate sales?

A. Yes, last summer I requested that such a study be performed by our research section.

(p. 228) Q. Okay, sir, and did you get that study back?

A. Yes, in September I received a cover memo from Brian Graham, who is in the research section, with a large report attached to it that went into possible losses that were occurring because we were unable to tax mail-order sales and went into the various formulas that they arrived at how—you know, at these figures.

MR. MENDEZ: Okay, sir. May I approach the bench, Your Honor? I'll have this marked as Defendants' Exhibit 13.

(At this time an instrument was marked as Defendants' Exhibit No. 13 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. Mr. Anderson, I'm going to hand you what's been marked as Defendants' Exhibit No. 13. Is that the study that you requested and that was provided to you, sir?

A. Yes, it is.

Q. And you say Mr. Graham's division is the one that handled that and—

A. Well, Mr. Graham, I believe, works directly under John Moore, but Brian Graham has (p. 229) been dealing with mail-order sales, as well as Phyllis Coombes.

Q. And does the Comptroller use these figures in his business and in determining whether to approach Congress to decide—to urge legislation to address the problems that are involved?

A. Yes, he has.

MR. MENDEZ: Okay. At this point we'd offer Defendants' Exhibit No. 13.

MR. GEORGE: I have no objection.

THE COURT: Admitted.

MR. MENDEZ: And I'm not going to be using this, if Your Honor wants to—

QUESTIONS BY MR. MENDEZ:

Q. Now, Mr. Anderson, can you tell the Court more or less how much money the Comptroller feels is at issue in the out of state sales without nexus situation?

A. Well, essentially the report looks at a maximum available, and they estimate it's between a hundred and a hundred and forty-five million dollars a year is probably being missed because we cannot require these out of state (p. 230) mail-order companies to collect the use tax for us. Any legislation, of course, that passed that would allow us to do that might have limits as to how large a company had to be before they would be required to collect the money either nationally—you might have a company that, say, had 12 million dollars in sales a year nationally before they would be required to collect the use tax, and they might have to have, you know, a hundred thousand or half a million dollars—whatever the cut off might finally be decided upon. If a very high cut off was used, that figure, a hundred and thirty million, of course, would drop, and it's just a function of the numbers.

Q. Okay, sir, and obviously there's a statute in place now that allows the Comptroller to collect a tax from users —the end consumers in this state, and why has the Comp-

troller decided to address the Congress of the United States on this issue, as opposed to trying to collect it from the consumers?

A. Well, when we perform audits we regularly pick up use tax from the sales tax permit holders who we do audit, if they have not (p. 231) paid it. Under the law a permit holder is supposed to report a use tax, but very often it is not reported. The problem with mail-order sales is that many of those sales are made to individual households and people who do not hold permits who would never be audited and are made in such large—such small dollar volumes that it would be uneconomical to audit them.

Q. Okay, sir, and so the Comptroller has made a decision not to collect a tax at that level but to address the Congress and to try to collect it from the sellers; is that correct?

A. Well, I'm not sure I can say he's made a decision never to collect it against a consumer, but he has certainly made the decision that it is in the economic best interests of the State to be able to require the seller to collect it.

Q. Okay, sir, and could you tell us what the status is of legislation before the Congress of the United States on this issue?

A. Well, a little brief history—last June—

MR. GEORGE: Your Honor, this is all really interesting, but what the (p. 232) status of some bill in Congress has to do with whether or not they try to collect the tax from people soliciting magazine sales in Texas is beyond me, and I think it's irrelevant, and I don't want to extend this simply—

THE COURT: What is the purpose? What's the justification?

MR. MENDEZ: Your Honor, Mr. George and *Texas Monthly* have been trying to ask the Comptroller's office why they haven't—if they have an action planned in the near future to collect a tax from these individuals—from individuals—

THE COURT: Is this to develop that they're looking to Congress for relief?

MR. MENDEZ: Yes, and I want to show that there are bills in Congress that are going to pass soon or might pass soon. There's a possibility of passing and that that's one reason why they may have forced all in one area—because they're looking to a better way of doing it.

THE COURT: And the excuse that the Comptroller is going to be offering is (p. 233) that we're looking to Congress for relief?

MR. MENDEZ: There's a better way of doing it.

THE COURT: I know but still basically that you're looking to Congress for the relief?

MR. MENDEZ: Yes, sir.

THE COURT: I'll sustain the objection.

MR. MENDEZ: We'll offer it in under a bill of exception, Your Honor, and I'll have the bill start at this point.

QUESTIONS BY MR. MENDEZ:

Q. Could you answer that question, Mr. Anderson?

A. I'm sorry. What the status of the present bills before the Congress are?

Q. Yes.

A. In June of this last year the NATA adopted a resolution to the effect that they would put forward legislation which would allow the states to collect use tax—require sellers to collect use tax in this situation. The State of Texas—I was on the resolutions committee at that time, and the State of Texas supported (p. 234) that resolution. Since then the bill has—that was proposed by the NATA has not been introduced, but two other bills have, which would allow this. One was by Byron Dorgan from the State of North Dakota, and his bill would allow the states to require mail-order companies to collect use tax on their behalfs [sic] without limitations. That bill is presently before the judiciary committee, and no hearing has been held in that instance. The second bill that has been introduced is by Senator Andrews, and that bill is presently before one of the subcommittees of the finance committee in the Senate, and a hearing has been held on that, and we sent a letter expressing our support for that bill. It, too, lacks limits, but there will be additional hearings on that bill. I would anticipate that sometime within the next month or so that the National Association of Tax Administrators bill will be introduced by a representative or Senator, but I don't know when that will occur.

MR. MENDEZ: That ends our bill, Your Honor.

QUESTIONS BY MR. MENDEZ:

(p. 235) Q. Now, I'll continue with the questioning. Mr. Anderson.

THE COURT: Is that all you're offering?

MR. MENDEZ: That's the bill of exceptions.

THE COURT: All right. I'll overrule the objection. I don't see that there's any—

MR. MENDEZ: So we'll eliminate the bill, in other words?

THE COURT: Right.

QUESTIONS BY MR. MENDEZ:

Q. Could you explain for the Court the State of Texas' affiliation with the Multi-State Tax Compact?

A. Yes. The State is a member of the Multi-State Tax Compact and has been since it was formed in 1967. We're just a regular dues paying member. We do participate in their audit program.

Q. What is the purpose behind the existence of the compact?

A. Well, essentially the compact is designed to bring more uniformity into the (p. 236) taxation of businesses throughout the United States. It was really formed as a direct response to the Willis Committee Report by the Congress—in Congress back in the mid-'60's, which called for multi-state legislation to tell states how to tax interstate businesses.

Q. Okay, sir, and has—you say you participate in their—in the MTC's audit program?

A. Yes, we do.

Q. Do you—have you always participated in that program?

A. With the exception of just a very few months, yes.

Q. Okay, sir, and could you explain for the Court how you got back into their audit program?

A. Well, I might first of all say that we had been in the audit program a number of years, and about a year and a half or so ago it was our conclusion that the State was not gaining enough from the audit program, and Harold Lee, who is with our office, and I both recommended to Mr. Bullock that we pull out of the audit program because of that. Thereafter, (p. 237) the formatting of the audit program was redone by MTC. I think we were not the only ones that were dissatisfied, and the emphasis was dramatically changed. I attended an executive meeting of the compact. I believe it was last—in mid-winter and expressed, you know, our concern with their auditing program and, you know, explained why we had gotten out, and at that time they indicated that they would move toward more sales tax auditing and concentrating on these mail-order type businesses, and it was for that reason that we really got back into their auditing program, and we paid, as I understand it, a special assessment strictly for that portion of their auditing program evolving around mail-order sales.

Q. Okay, sir, and do you think that this audit program that you've contracted for would spot and—or would detect and then get into your jurisdiction or at least put before it—the courts again the issue of who has nexus and who doesn't have nexus?

A. Oh, I would certainly hope so. You know, that's the purpose of it.

Q. And do you think that's a better way (p. 238) of collecting taxes than going after the end consumer?

A. Yes.

Q. And so if *Reader's Digest* is subject—or were to become subject to an MTC audit and was assessed a sales or use tax for the State—for its circulation into the State of Texas and, let's say, the MTC did something like that, would the Comptroller issue an assessment after they had done their audit?

A. We would stand behind that finding, yes, and they would have all of the full rights. You know, they would have rights to a redetermination hearing and the full set of rights that would be granted to anyone else when an assessment was issued.

Q. Okay, sir, and without mentioning any names, has the MTC in the past generated funds from these nexus type cases?

A. Yes, they have.

Q. Okay, and is that one of the considerations or one of the reasons you went back into the program?

A. Very substantial amounts of money have been received because of this. Now, they (p. 239) have not gone to court. They have—you know, essentially, MTC has gone in to do audits, and even where nexus was very, very questionable, the companies have agreed to pay back taxes, as well as to start collecting a use tax in the future on our behalf.

Q. So to the extent—well, what kinds of specialized resources does the MTC have that you're counting on to use in this—in your search for out of state companies that have nexus but are just hard to detect?

A. Well, first of all, they have an overriding interest in it. It is not just a segment of an auditing program. The mail-order business has become one of the driving points of interest for the MTC, which is always good, but aside from that, they also have very competent auditors, which our staff has evaluated and found were very competent and that they not only know our laws, but they know a number of State laws, and they are versed in nexus problems, and they also have three full-time attorneys with very high qualifications in the area that deal day in and day out with the problem, which we just generally do not do. So they're very—(p. 240) you know, they're very qualified in the area.

Q. Now, sir, turning back to the legislation portion of this testimony—

MR. MENDEZ: I want to first have these exhibits marked as Defendants' 14, 15 and 16.

(At this time instruments were marked as Defendants' Exhibits Nos. 14 through 16 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. I'm going to hand you, sir, some documents which you provided to me earlier. Can you identify Defendants' Exhibt No. 14?

A. Yes, this is the September issue of our fiscal notes containing an article on mail-order sales.

Q. Okay, sir, and is that a document that you've used in your work with the—with this interstate sales business legislation?

A. Well, I've kept it in my file. I don't know that I've actually worked with it. It's something I've received.

Q. To the best of your knowledge, is this information that was gleaned—or the information here is a policy of the Comptroller (p. 241) or the position of the Comptroller, with respect to the issue of states missing out on mail-order sales tax?

A. Yes, it is.

Q. And that's a position that you put forth to the NATA and to others; is that correct?

A. Yes, it is.

Q. Okay, sir, what issue is this again? When was it published?

A. September of '85.

MR. MENDEZ: Okay, sir. I'll offer Defendants' No. 14.

MR. GEORGE: Let me take the witness on voir dire briefly.

VOIR DIRE EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Is Exhibit 14 in some kind of newspaper?

A. It is a—just a brochure that we print and we mail to a number of subscribers. It's—they—it is not a charge for—

Q. You don't charge—

A. We don't charge—we don't charge for this one. You, too, can get on the list to (p. 242) receive Fiscal Notes.

Q. And the purpose of this is to explain the information contained in that other exhibit—what the numbers were?

A. I don't know if that's the purpose. I think this particular issue simply talked about mail-order sales in general and how the lack of our ability to require collection was costing the State money. The publication itself is put out regularly and addresses all sorts of issues of general concern—oil prices and a section in the back, which I never read or really understand, the Monthly Statement of Cash Condition, but it has some meaning for accountants and—

Q. Is there anything—

A. —around the state.

Q. Excuse me. Is there anything, Mr. Anderson, in this Exhibit 14—is that the number—

A. Yes, sir.

Q. —that has anything to do with magazines?

A. Not specifically as I recall. I don't recall that it's directly—

(p. 243) MR. GEORGE: I object on the grounds it's not relevant to any issue in this case.

THE COURT: Let's see it. What's—

MR. MENDEZ: He has an objection.

THE COURT: I know—on relevance. What is the relevance?

MR. MENDEZ: Your Honor, I'm trying to establish what the Comptroller is—that the Comptroller is attempting to equally enforce the tax against all—or collect all of the tax that is due, and this is an effort that he is making to attempt to carry out that objective and to the extent that Mr. Bullock has been lobbying Congress and has been—

THE COURT: You're getting a lot of extraneous in here. I'm going to overrule it, but I'm going to—

MR. MENDEZ: Well, we'll try to limit it.

THE COURT: That's your only objection is the relevancy?

MR. GEORGE: That's the (p. 244) only objection.

DIRECT EXAMINATION (Resumed)

QUESTIONS BY MR. MENDEZ:

Q. Could you identify Defendants' Exhibit No. 15?

A. This is a copy of a newspaper article—a letter to the editor that appeared in *The New York Times.*

Q. Who wrote that?

A. Mr. Bullock is the name that is signed to the bottom of the article.

Q. Okay. Is this also information that you have with respect to the efforts of the Comptroller to get legislation passed on this sales—

A. This also is just in my files.

Q. Yes, sir, and how about Exhibit No. 16—Defendants' Exhibit No. 16?—Can you identify that document?

A. This is a letter that was sent to a Craig Hines. The letter, which is signed by Tony Proffitt, attaches another letter, as I recall—let's see—attaches a letter to Jack Brooks. I wrote the letter—the rough draft (p. 245) letter for Mr. Bullock's approval to Congressman Brooks, in which he asked that the legislation be supported because we're taking a loss in our mail-order sales area. This was sent to Craig Hines for his information and use, I presume.

Q. And on the last page of that exhibit, is there a list of other persons that received that letter?

A. Yes, there is.

Q. What types of companies are those?

A. They are all newspaper companies, with the exception of the Associated Press, which I guess would be a news gathering company.

Q. And what—generally what is that? Well, is that another document—well, you prepared the actual letter that's enclosed—

A. Well, I had nothing to do with the letter that was sent out by Mr. Proffitt. The attachment to that letter to Congressman Brooks I did do the rough draft on.

MR. MENDEZ: I'll offer Defendants' 15 and 16.

MR. GEORGE: Your Honor, Mr. Bullock's letters to *The New York Times* and his letters to Congressman Brooks and to newsmen (p. 246) are again not relevant to this lawsuit.

MR. MENDEZ: We urge the same argument, Your Honor—that they explain his position in attempting to collect the tax in the most reasonable manner that's possible and from the sources that it really can be collected at.

THE COURT: Well, where is it directed to publications? I guess that's really what his objection has been all along. Where is it to—with reference to publications?

MR. MENDEZ: It was sent to the editors of several major—the publishers of several major newspapers in the State of Texas, and you know, it's showing them that there's an effort going on in the federal—and a lobbying effort to the legislators—the Congressmen from Texas to try to get that law passed.

THE COURT: Well, what I've heard—if it's a necessary fact, we'll stipulate to it, but I just don't see—we keep cluttering up the record here with things. It seems to me we're building a record on—

MR. MENDEZ: Your Honor, (p. 247) I'm trying to build the record to show—I'm trying to show from the constitutional cases that I've read—and I'm not, you know, saying that I'm the greatest constitutional lawyer or anything, but every one of those cases that talks about discrimination on an as supplied basis by a State official—everytime you have a legitimate defense of that you've got to show that you have a rational basis for treating that group of people differently, and what I'm trying to

show is there's no way for us to collect it from the consumer. There's an equal statutory liability on the retailer, and we're trying to get the legislation to get over there and overcome any burdens at the federal level that might exist under the federal constitution.

THE COURT: All right. I'll overrule the objection.

QUESTIONS BY MR. MENDEZ:

Q. Thank you. Turning now, sir, to the area of exemptions of religious periodicals, have you ever had occasion to consider any policy of the Comptroller or are you aware of any policy of the Comptroller to look to the content of any publication to what's written in (p. 248) a magazine or other document to decide whether or not to apply tax?

A. I have not.

Q. Now, we might have—we've shown the Court, I guess, today that there are efforts going on with the MTC and the Federal Congress. Have you stopped any audits that might be in progress, or have you stopped the enforcement people or sent them notices in the Enforcement Division that they not do any work with regard to trying to locate anybody that's liable for taxes?

A. No, I would expect that they would, you know, continue to do so.

Q. And if the testimony were or if the Audit Division went out and had a system in place by which they identified persons that might be doing business in Texas

and that system is working today right now, is there any reason why you'd stop them or is there any order—

A. I would encourage them. I assume Mr. Bullock would encourage them, as well.

Q. And so all of these efforts that we're talking about today are supplements, aren't they, or what are they in comparison to (p. 249) what your normal audit programs and enforcement programs are?

A. Well, of course, I'm not in audits, but my understanding is that we have an ongoing problem—problem and program with trying to identify people who are actually doing business in this state, and I have been contacted on a number of occasions as to whether sufficient nexus exists with various companies. You know, whether—well, merely delivery into Texas is sufficient nexus or if they have an office here—whatever, but those are ongoing enforcement and audit type problems, and I only see them when somebody brings a question to me. Now, they are brought to me, and on the other occasions I will be asked —information will be sent to me concerning people doing business in the state, and when that happens, I turn around and send it to either the Tax Administration Division or to our Enforcement Division to find out whether or not they're doing business.

Q. Now, it might not have been clear, without mentioning any names, but did the situation where an audit of the MTC might have resulted in funds delivered to the State of (p. 250) Texas—was that the audit of a publishing company or—

A. There was—one of the parties involved was a publishing company, yes, sir.

Q. Okay, and would that—well, is that one of the reasons why you decided to go into that special audit program that they have?

A. It was one of them.

MR. MENDEZ: Pass the witness.

CROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Let's try to be brief here, Mr. Anderson. First of all, religious periodicals. You're familiar with the statute, are you not?

A. I am, but it's been a long time since I've really looked at it.

Q. And you're—I assume the Comptroller follows the statutory language when it applies to exemptions?

A. I would hope we do.

MR. GEORGE: All right, and may I approach the witness?

QUESTIONS BY MR. GEORGE:

(p. 251) Q. The language of that statute says, "Periodicals that are published or distributed by a religious faith that consist wholly of writings promulgating the teachings of the faith are exempted from the taxes imposed by this chapter," and that requires an analysis of whether the teachings or whether the writings in that periodical are teachings of the faith, don't they?

A. The only—I only remember one instance where I have ever had occasion to look at that particular pro-

vision, and that was about, oh, 12 or 15 years ago involving a religious bookstore, and we did not, in fact, look at the content.

Q. You just ignored the statutory language?

A. I'm merely telling you what happened at that time. I do not know what happens now, but I've never seen anyone really analyze religious periodicals.

Q. Okay. Next issue. You talked about nexus being a difficult problem?

A. Yes.

Q. It's not a difficult problem, if (p. 252) people have representatives in this state soliciting orders, is it?

A. No.

Q. In fact, there is—the statute of the State of Texas says that's nexus?

A. That's right.

MR. MENDEZ: Your Honor, if I may? You're making me real nervous standing here. I don't think under the local rules—

MR. GEORGE: I'll be happy to sit down. I was going to approach the board here in a minute.

QUESTIONS BY MR. GEORGE:

Q. In addition the case law says that's perfectly within the Constitution of the United States, doesn't it?

A. That's right.

Q. You're a lawyer and very familiar with these issues?

A. That's correct.

Q. And you subscribe to magazines?

A. Yes, I do.

Q. And you subscribe to out of state magazines?

(p. 253) A. Yes.

Q. Which ones?

A. *International Living.*

Q. Where is that published?

A. New Jersey or someplace like that. I don't really remember.

Q. All right. Anything else?

A. *Islands.*

Q. Where is that published?

A. A little fantasy time here, I think. Also out of state. I don't remember. *Texas Monthly,* you'll be glad to hear.

Q. Mr. Levy will be particularly glad to hear that.

A. And *TV Guide,* and I think at present those are the only magazines I subscribe to.

Q. Do you pay use taxes on those out of state subscriptions?

A. I have no idea whether I'm paying a use tax or not. It is not specified.

Q. Do you remit it on out of state magazines that are mailed to you?

A. No.

Q. And you know that's—

A. I don't fill out a use tax form and (p. 254) send it in.

Q. You understand that's the general practice in this state?

A. I believe that, you know, it would probably be the case but I don't know.

Q. And let me ask you are you aware that at the time this statute became effective involving the taxes on magazine subscription sales that the Comptroller's office, Mr. Castlebury—Mr. Castlebury is senior official in the Comptroller's office, is he not, sir?

A. He is Associate Deputy Comptroller. He is senior official, yes.

Q. And he was supplied with the knowledge that people had—that magazine publishers from out of state had folks coming in the state soliciting orders through school agents. Do you know that?

A. The—from what I understand with conversations with Mr. Castlebury is that it becomes a very interesting question as to who is soliciting for whom, and it is probably a very delicate constitutional question when you have a —what I would call a daisy chain situation. Like I say, it's been described to me a magazine will (p. 255) employ Publishers Clearinghouse or ask for names, as they call

it, who will then go to brokers, who will then go to other parties, and you may have a whole series of parties involved before the little Girl Scout or the guy working his way through college comes to the door.

Q. You understand that if somebody takes an order for a publisher in this state, under the statutes of this state and under a Scripto case out of Florida—if an independent contractor or any employee or anybody else takes orders, that's within the power of the State to tax that—those people as doing business?

A. I would argue—I consider that a close constitutional question. I would basically agree with you, however, in that I think that that is probably going to be tested, and hopefully, you know, we will find an answer to that question out.

Q. You think that's a close question? Is that your testimony?

A. I think that is a close constitutional question, yes, sir.

Q. In connection with the people who come into this state soliciting orders for all (p. 256) kinds of machinery and other things of that nature, you claim those people are doing business in Texas, don't you?

A. In most instances those are directly tied the way you have—the way I understand your example—to the manufacturer. Now, when you start putting intermediaries between the person making the sale, then you have, you know, questions that are raired.

Q. Mr. Anderson, you know that it is common practice in the electronics industry. It is common practice in al-

most every modern industry to have what you call sales representatives, people, independent contractors who peddle multiple lines of electronic goods that come through the states taking orders for those goods. You know that, and you know that that's treated as doing business in this state, whether those people are independent contractors working for themselves or employed by some other organization, and you treat them as doing business in this state, and you have a different rule for magazines. That's right—

A. It is my understanding—it is my understanding that that is not what we do— (p. 257) that if they—there are layers between the salesmen and the company ultimately making the sale. I don't believe at this time we have been picking up those sales between—not for magazines but for any sale of goods. Now, that may or may not be correct. As far as our policy, I think you've had other people testifying on that, but that's my understanding of the policy.

Q. It's the legal position of the State of Texas that if there is a non-employee—a person—

A. No, I'm not going to take that as legal position. What I'm saying is our present position is that we have not picked up facts in that instance where there have been intermediaries between the seller and the ultimate salesmen. That is our—what we have done presently.

Q. That's what you're doing?

A. That is what we're doing for everyone—not just magazines but for everyone, and what I'm saying is that may or may not be correct, and maybe we should be proceeding against the other intermediary.

Q. Well, you do that intentionally? (p. 258) You take that policy and made that decision and are intending to do it that way?

A. Because we consider that with intermediaries you have a constitutional question, yes, sir, that is correct.

Q. There isn't any case law to support that position, is there, Mr. Anderson?

A. If there is real good case law to support the position that it was not, we would probably pick it up. Now, you have the Scripto case, of course—

Q. Which is directly on—

A. —which is an independent contractor situation, but you don't have in the Scripto, as I recall—it's been a while since I've read Scripto truthfully, but as I recall that was not a situation where you had layers of people between the company making the sale and the independent contractor.

Q. If I am a company that contracts to sell *Reader's Digest* subscriptions and I hire people to go into there, and your position is that I am not—those people don't have any relationship with *Reader's Digest* or relationship with their employer, and they take (p. 259) orders. They're not—*Reader's Digest* is not doing business in this state?

A. My position is that they may well be doing business, but we have not gone to the layered—we have not gone into the layering situation.

Q. Now, as I understand it, there is no concerted effort made by the Comptroller's office in any form to

try to encourage voluntary compliance by non-business taxpayers to pay their use tax?

A. I'm sorry. I just didn't really hear your question very well.

Q. As I understand it, there is no organized policy by the Comptroller's office to encourage voluntary compliance with a use tax obligation of non-business users of out of state products; is that right?

A. I think we put out brochures advising people of their use tax obligation, but as far as I know, that would be about the limit of our—any program that we might have.

Q. Yes, sir, and you had a study done, and about—what—a hundred and forty-five million dollars a year is being—

(p. 260) A. It varies to a hundred and forty-five.

Q. A hundred and thirty to a hundred and forty-five million dollars a year being lost for not collecting use taxes that are owed; is that right?

A. Not being able to economically collect use taxes that are owed, yes.

Q. Now, that's what you're not collecting—a hundred and thirty to a hundred and forty million dollars?

A. That's probably right.

Q. And you have done absolutely no studies and no work on how one could encourage some voluntary compliance to pick up some of the money from the people who owe the money, which are the users of those products?

A. I cannot tell you that nothing has been done in that area because the Comptroller's office is a big office, and people may have done some things that I'm unaware of. I'm unaware of any program, as you describe, other than simply letting the public know that use tax is due on the items purchased from out of state, and we have done publicity on that is my understanding.

(p. 261) Q. But, Mr. Anderson—

A. In answer to your question, I'm unaware of any program, as you describe it.

Q. Mr. Anderson, there is lots of money out there to be collected, isn't there?

A. Yes, there is.

Q. And you understand that we have all kinds of voluntary rendering systems of paying taxes in Texas. Ad valorem taxes are voluntarily rendered. It used to be taxes on intangibles were voluntarily rendered. That's tradition in this state, isn't it?

A. Well—

Q. You as a lawyer know that?

A. Yes, and you have different degrees of success in those programs, as well.

Q. Yes, sir, and those programs have been used, and enforcement encourages compliance?

A. Sure.

Q. Highly visible enforcement is taken by your—

A. You know, voluntary—any tax program has to operate through voluntary compliance.

Q. Yes, sir, and, Mr. Anderson, you (p. 262) know that your company—your company—the Comptroller's office goes out and enforces the tax obligation against one particular taxpayer spending a lot more money with your raids and other things that you have done in the past on noncomplying taxpayers, although you may not get all of the money from that one collection. So you get publicity that you're out enforcing it, and you do that to encourage other people to pay their taxes?

A. That's right.

Q. And you haven't tried that one time? You haven't taken the newspaper reporters and everybody and gone down to pick somebody—I saw in the paper the other day that the Governor's wife bought a coat in New York—gone down to Governor White's office and found out if she paid her sales tax. You would have probably got a lot of publicity on the obligation to pay taxes then, wouldn't you?

A. Well, that's—I'll have to pass that along to Mr. Bullock. We, of course, do go after large items that are purchased by individuals.

Q. By businesses?

(p. 263) A. No, not businesses—large items purchased by individuals where we can identify them but you've got—

Q. Airplanes and boats?

A. Airplanes and boats, but you've got two things that make that possible. One, the dollars involved make it economically possible, and two, you've got a record as to

who has purchased the item. It is—for instance, let's—if we wanted to go after a magazine, let's say, or let's say J. Bean—J. Bean?

Q. L. L. Bean?

A. L. L. Bean. Close. All right. L. L. Bean.

Q. When you buy your island, you might want to—

A. All right. Might need some of that. If we wanted to go to L. L. Bean and said, "All right. We want to know everybody that has purchased items in Texas so we can—we know we can't require you to do that because you don't have any nexus, but we want to see the records of all of the people that purchased items from L. L. Bean so we can go to each one of those and say, 'You know, pay us the $2 in tax, the $1 in (p. 264) tax, the $5 in tax or whatever it happens to be,' " L. L. Bean would simply refuse to make their records open to us.

Q. What I'm asking you, sir, is you have testified that you don't think it would be economical to try to collect the tax from regular consumers, non-business use tax obligees?

A. All right. That's correct.

Q. You don't think that?

A. I don't think that.

Q. And the question—and you have made, however, no studies of what you could do. You have made no efforts to try it and see what happened. You have done absolutely nothing, except we've come to the conclusion that you don't

think it could work under any circumstances. Isn't that the facts, Mr. Anderson?

A. Other than just general advertising, I think that is basically true.

Q. All right, and isn't it also true that the Legislature passed this tax obligation on you and me making us obligated to pay the use tax on the magazines—*Island* magazine and *International Lifestyle* and whatever I subscribe (p. 265) to, and your department of government is obligated to enforce that tax, whether you think it's a good idea or not?

A. Well, I don't think that the Legislature would contemplate us trying to spend, you know, $5 to collect 50 cents.

Q. I understand that, but don't you need to go out and try to see what you could do before you just write it all off—write that hundred and forty-five million dollars off and say, "Congress, help me"?

A. Well, quite frankly, other than advertising through brochures and letting people know that there is an—you know, a liability, quite frankly I don't know what else you'd do.

Q. How about some enforcement actions that's all publicized? Go to somebody's—go to Judge Dibrell's house and see if he bought anything.

A. Let's say that we did go ahead and go to Mark White's wife and say, "Did you pay tax on that?" and she says, "Sure did," or "Sure didn't"—one or the other and—but let's say that she didn't. She may well have

done so, but what—how much enforcement would you get out (p. 266) of that for someone who had purchased an item in Oklahoma while they were on vacation or purchased something while they were—through a mail-order house that was $5? Do you really expect that they would go to the trouble or be so afraid of the Comptroller's office coming after them for $5 in tax that they would fill out a use tax return and send it in to us? I personally don't believe that would happen, but that is merely a belief on my part.

Q. Do you know that, in fact, people— sometimes there are some citizens of this state that come in and bring you a check because they know that's their obligation, and they pay it. They don't have to fill out any form. There's no form required. There's nothing required except putting the money in the bank?

A. I have worked for the Comptroller's office for about 20 years and I'm not saying I haven't seen it, but I could probably count those instances on one hand that I have.

Q. But it can be done?

A. It could be done, but it's not a practical way of collecting the money.

Q. But if you encourage people to (p. 267) comply —simply tried once to tell people through enforcement actions that that's their obligation—I mean, when I get one speeding ticket, it affects me and my wife and my 17-year-old son and everybody in my household.

A. Well, of course, following that line of reasoning, we do exactly that with boats and airplanes. You know,

when the guy has bought the boat or the airplane and brought it into Texas, it does exactly what you're asking us to do with the Governor's wife.

Q. You haven't done anything to get publicity for it. You don't have a general campaign. You simply write off the hundred and forty-five million dollars and go to Congress. That's what's happening, isn't it?

A. All right. If what you're saying—we write off the hundred and forty million or thirty million—whatever it is—in the sense that we don't start a campaign to get everybody to report every cent they owe in terms of, you know, the hundred and fifty dollar tent that somebody buys and has mailed into them or the $10, you know, Walkman, you know, I can't say that we'd make a great effort to do that, but I (p. 268) don't believe that it would bring in just much money, but there again you're talking about a belief, and I can merely tell you what we've done.

MR. GEORGE: Pass the witness.

MR. MENDEZ: No questions.

THE COURT: You may step down, sir.

THE WITNESS: Thank you.

MR. MENDEZ: We'll call Mr. Harold Lee. I understand we've called our last witness up—he was on call—on the phone, you know, and he's on his way over here, and I'll try to be as brief as possible. I just want to build this record on this one point.

THE COURT: All right, sir. You've been previously sworn, haven't you?

THE WITNESS: Yes.

HAROLD LEE

was recalled as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

(p. 269) QUESTIONS BY MR. MENDEZ:

Q. Mr. Lee, you've testified about some things that Audit Division might not have done when Mr. George called you earlier. I'd like for you now to explain to Your Honor a little bit about what the Audit Division does. How many people does the Audit Division have right now?

A. The Audit Division has slightly over 700 people.

Q. Okay, and where are these people located?

A. Our personnel are located nationwide to a degree. We have 21 offices throughout Texas and the nation. There's four offices located outside of Texas and 17 offices located in Texas. Of our 700 plus people, there's 70 of those personnel in our out of state offices and the remainder in our Texas based offices. Out of this 700 plus people, there are about 30 people in our audit headquarters which are support personnel. Within the 700 total people, there are 525 auditors, 46 audit group supervisors, 21 audit managers, approximately 25 audit technicians, who assist auditors in (p. 270) conducting audits, 70 some-odd administrative personnel.

Q. Okay, sir, and you use—well, what are the function of all of these auditors that are out there? What do they do for this office?

A. The primary function for the auditors is to audit businesses doing business in Texas for the various taxes

administered by the Comptroller's office, of which there's approximately 30.

Q. Okay, sir, and could you give the Court an idea of how many audits that group does during the period of a year?

A. In fiscal 1985 we did approximately 23,000 audits. In this fiscal year 1986 we plan on doing somewhere in the neighborhood of 25,000, 26,000 audits.

Q. Okay, sir, and about how much revenue did those audits generate last year?

A. Last year we generated assessment somewhere in the neighborhood of 280 million dollars.

Q. Okay, sir, and could you explain for the Court briefly the audit select systems that you may have in place so that these auditors can (p. 271) be used effectively?

A. The sales tax on a select system deals a lot with protecting the tax base we have. The first thing we look at or the first accounts we look at are approximately 46 to 4700 accounts that pay 65 percent of the total revenue—sales tax revenue to the State each year. These 4600-plus accounts are audited every four years, which is our statute of limitations. There are a few counts [sic] that come in and go off at the lower end of the 65 percent. We run a new list every six months on this, and it is provided to the audit offices for them to work from and select accounts.

We—I'll go back and say we have some centralized audit select, and then a lot of the audit select is decentral-

Section 151.312 violates all three prongs of the *Lemon* test and is plainly unlawful.

CONCLUSION

The judgment of the Texas Court of Appeals should be reversed and the judgment of the district court affirmed.

Respectfully submitted,

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NO. 87-1245

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1987

TEXAS MONTHLY, INC.,
Appellant

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS,
THIRD SUPREME JUDICIAL DISTRICT
OF TEXAS, AT AUSTIN

BRIEF FOR APPELLEES

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ON APPEAL FROM THE COURT OF APPEALS,
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OF TEXAS, AT AUSTIN

BRIEF FOR APPELLEES

STATEMENT OF THE CASE

In seeking to recover the sum of $149,107.74 paid under protest by it, Texas Monthly Inc., hereinafter called Texas Monthly, has appealed a decision of the Court of Appeals, Third Supreme Judicial District, Austin, Texas, holding that Section 151.312, Texas Tax Code, does not violate the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution and the Free Press, Free Speech and Establishment Clauses of the First Amendment of the United States Constitution.

Texas Monthly publishes a general interest magazine, Texas Monthly, on a monthly basis. It has

challenged Section 151.312 by making tax payments for the period from January, 1985 through November, 1985 under protest pursuant a state law procedure, Tex. Tax Code Section 112.051. It contested the tax it reported on its monthly tax reports as the reports became due. The amount represents tax due on Texas Monthly's subscription sales of magazines. These sales were for a semiannual or longer period of time. The tax was not collected by Texas Monthly from its customers because it made a business decision that it was not economically feasible to collect the tax. J.A. 153, 154.

Before October 2, 1984, subscription sales of magazines sold for a semiannual or longer period and entered as second class mail were exempt from the application of the Texas sales and use tax. Section 151.320, Texas Tax Code. Effective October 2, 1984, the exemption for these sales was repealed and they became subject to the sales and use tax. Sales of magazines from a newstand were subject to tax, both before and after October 2, 1984.

Effective October 1, 1987, an exemption for magazines was enacted and appears again as Section 151.320 in the Texas Tax Code. Subscription sales of magazines are therefore currently exempt. Between October 2, 1984 and September 30, 1987, the only exemption for magazines, which were sold, appeared in Section 151.312, the religious periodical exemption. From October 2, 1984 through September 30, 1987 all sales of magazines were taxable under the Texas Sales and Use Tax Act except for sales of religious periodicals.

Texas Monthly in its brief indicates that sales of its magazines from a newstand have been and continue to be subject to state sales and use tax. The sales of these magazines were made by Texas Monthly to

retailers, who in turn sold the magazines to customers. The retailers collected the tax. J.A. 122. Since they were sales for resale, Texas Monthly was not responsible for and did not collect the tax on sales of its magazines from newstands. J.A. 138, 139.

The tax Texas Monthly seeks to recover relates only to subscription sales of magazines in 1985. On and after October 1, 1987 Texas Monthly owes no tax on any of its magazine sales.

For the period in issue, Texas sales and use tax was due from all sellers of tangible personal property including magazine publishers. It was imposed on each sale of tangible personal property in Texas and upon a seller engaged in business in Texas who made a sale for storage, use or consumption in the state. Texas Tax Code Sections 151.051(a), 151.010 and 151.103. Sellers making sales were required to bill and collect the tax from their purchasers. Texas Tax Code Sections 151.052 and 151.103.

The trial court ruled in favor of Texas Monthly concluding that the exemption in Section 151.312 violated the First and Fourteenth Amendments of the United States Constitution. J.S., App. 47. It made findings of fact that there were periodicals that qualify under the language in Section 151.312 as religious publications which are regularly circulated in Texas and there was no basis for the exemption of such periodicals other than the promotion of religion itself. J.S., App. 46, 47.

The trial court did not find the evidence established that the sales and use tax system in Texas operates to discriminate against magazines selling to subscribers in general and Texas-based publishers in particular. Texas Monthly raised as an issue in its

Second Amended Original Petition that the Comptroller had entered into an intentional plan to collect sales tax from only those magazines that had offices in Texas, such as Texas Monthly, and was making no effort to collect sales tax from companies selling magazines in Texas, which had no offices in Texas. J.A., App. 6. It also asserted as a ground of recovery that the imposition of tax on magazine subscription sales discriminated in its operation against the magazine industry since there was no effective way to collect the tax from readers and the tax operated as a gross receipts tax as it affected magazines sold through mail subscriptions. J.A., App. 7.

In its judgment, the trial court held, "Since the Court has concluded that because the legislature has exempted periodicals described in Section 151.312 from the tax and not exempted Plaintiff's periodicals, collection of the tax from Plaintiff violated the Constitutions of the United States and Texas. It is therefore unnecessary for it to make findings of fact and conclusions of law on the other issues raised by Plaintiff's pleadings and none are made." J.S., App. 44.

An appeal was taken by the Appellees to the Court of Appeals, Third Supreme Judicial District, Austin, Texas. The Court of Appeals held in a majority decision that Section 151.312 did not violate the Fourteenth Amendment equal protection clause by unconstitutionally discriminating between periodicals based on content. It also decided that Section 151.312 did not violate the free press and free speech clauses of the First Amendment of the United States Constitution. The Court of Appeals addressed the establishment clause of the First Amendment, but only as a part of its equal protection analysis. J.S., App. 4. The Court of Appeals refused to address Texas Monthly's other discrimination arguments because Texas

Monthly had failed to properly raise these issues for appellate review. J.S., App. 11, 12.

SUMMARY OF ARGUMENT

I. Texas Monthly lacks standing to attack Section 151.312. The tests for standing are the party invoking the court's authority must show first he personally has suffered some actual or threatened injury as a result of the putatively illegal conduct of the defendant and second the injury fairly can be traced to the challenged action and is likely to be redressed by a favorable decision. *Valley Forge Christian College v. Americans United for Separation of Church and State*, 454 U.S. 464, 472 (1982). Even if this court should find that Section 151.312 is unconstitutional, this holding should not offer the relief Texas Monthly seeks, which is the recovery of the amount paid to the Comptroller. Texas Monthly's injury, if any, is only for a limited period of time and is not continuing. If Section 151.312 is declared unconstitutional, the exemption provision should be held invalid but the tax should stand. Texas Monthly's constitutional attack on Section 151.312 does not hold the promise of escape from the burden of the tax itself and Texas Monthly lacks standing to challenge Section 151.312.

II. The Texas tax is not discriminatory. Under the Texas Sales and Use Tax Act, sellers of tangible personal property must add the tax to the sales price of the property and collect it from their purchasers.

During the period in issue, all sellers of magazines and other periodicals were required to collect and remit tax on their sales except sellers of religious publications.

There is no selective content based taxation of certain magazines by taxing all but one type of magazine. For content discrimination to apply to a tax provision, the press must be singled out for different treatment from other enterprises or a small group of the press must be targeted by the tax. The Texas tax does not treat the press as a whole differently from other sellers and it does not target a small group within the press for taxation. *Arkansas Writers' Project Inc. v. Ragland*, 107 S.Ct. 1722 (1988).

Unlike the tax in *Arkansas Writers' Project Inc. v. Ragland,* supra, which was discriminatory, the Texas tax does not discriminate. The Texas tax provides for a single religious exemption, which the Legislature has found to be useful to accommodate religion, to reinforce the desired separation of church and state (it provides neutrality toward religion), to attempt to avoid excessive entanglements with religion and violations of the Free Exercise Clause.

If this Court finds content based discrimination under the Texas Sales and Use Tax Act, the Comptroller submits this decision cannot be reconciled with previous decisions of the Court and should be overruled for the reasons discussed by Justice Scalia in his dissent in *Arkansas Writers' Project v. Ragland*, supra.

III. Section 151.312 does not constitute a "law respecting the establishment of religion." The Constitution mandates accommodation of all religions. The purpose of Section 151.312 is to accommodate religion. If accommodation is not afforded, there can be intrusion on the state's interest in promoting the First Amendment's guaranty of free exercise of religion.

This exemption meets the three part test set out in *Lemon v. Kurtzman*, 403 U.S. 602, 612-13 (1971). It

has a secular legislative purpose of accommodating religion neutrality toward religion. It restricts the fiscal relationship between church and state and reinforces the desired separation insulating each from the other. *Walz v. Tax Commission*, 397 U.S. 664, 676 (1970).

It neither advances nor inhibits religion but creates only a "minimal and remote involvement between church and state and far less than taxation of churches." A law is not unconstitutional simply because it allows churches to advance religion. Section 151.312 does not present a symbolic union endorsing religion.

It does not create an excessive entanglement with religion. The reviewing of a book to determine its content, if this must be done, does not violate the third part of the *Kurtzman* rule any more than determining whether property is being used exclusively for religious purposes by a religious organization. *Mueller v. Allen*, 463 U.S. 388 (1983) and *Walz v. Tax Commission*, supra. There is no continuing state surveillance in the review of a periodical to run afoul of the third standard.

The agency interpretation of Section 151.312 should be considered. This interpretation has been to let the parties to a sale transaction determine whether the publications are exempt.

ARGUMENT

I. APPELLANT LACKS STANDING TO ATTACK SECTION 151.312.

Texas Monthly seeks to recover the amount of $149,107.74 paid under protest to the Comptroller. Texas Monthly has attacked an exemption and not the tax.

Section 151.312 is a part of the Texas Tax Code. The Texas tax statutes were codified into this Tax Code in 1982 by the 67th Legislature. The Code, when enacted, did not contain a provision for severability. The Texas Code Construction Act, which appears in the Texas Government Code, applies to the Tax Code[1] and provides in Section 311.032(c):

> (c) In a statute that does not contain a provision for severability or nonseverability, if any provision of the statute or its application to any person or circumstances is held invalid, the invalidity does not affect other provisions or applications of the statute that can be given effect without the invalid provision or application, and to this end the provisions of the statute are severable.

Under these state statutory provisions if Section 151.312 is invalidated, this Section should fall and not the tax because the tax could be given effect without the exemption. Even if these provisions were not present, the exemption and not the tax should be invalidated. "The cardinal principle of statutory construction is to save and not to destroy." *Tilton v. Richardson*, 403 U.S. 672, 683 (1971). There is no basis for invalidating the tax because the tax is nondiscriminatory on all magazine sellers.

Texas Monthly admits in its brief (Appellant's Brief, p 16) that it is the exemption and not the tax

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[1]Section 311.002 provides:

This Chapter applies to:

(1) each code enacted by the 60th or a subsequent legislature as part of the state's continuing statutory revision program.

which gives rise to examination. To strike the tax and make all periodicals (except over the counter sales) exempt would defy logic. If the offending provision is the exemption, it should be invalidated.

In *Arkansas Writers' Project Inc. v. Ragland*, supra, the standing of the taxpayer to attack the tax statute was raised by the Commissioner of Revenue, the taxing authority. This court determined Arkansas Writers' Project had standing to challenge the Arkansas tax scheme because it had alleged a sufficient personal stake in the outcome of the litigation and its constitutional attack was its only means of relief from the burden of the tax.

This court in *Valley Forge Christian College & Americans United for Separation of Church and State*, 454 U.S. at 472, set out the tests for standing of a party as first, the party must show he personally has suffered some actual or threatened injury as a result of the putatively illegal conduct of the defendant and second, the injury fairly can be traced to the challenged action and is likely to be redressed by a favorable decision. Texas Monthly asks this court to declare Texas Tax Code Section 151.312 unconstitutional and allow it to recover the money it has paid to the Comptroller. With the change in the Texas tax scheme, the redress requested by Texas Monthly is only for a limited time period and cannot be requested for periods after September 30, 1987, which is unlike the situation in *Arkansas Writers' Project* where the challenged statute was still operative. Texas Monthly's attack is to the exemption in Section 151.312. Even if this exemption was invalidated as being in violation of the Constitution, the tax itself should stand. One exemption from an otherwise equal tax should not invalidate the tax if the exemption is held to be invalid. Texas Monthly should have no right to recovery of the money it paid

the Comptroller by seeking to invalidate the exemption.[2]

II. THE TEXAS SALES AND USE TAX SCHEME DOES NOT UNCONSTITUTIONALLY DISCRIMINATE BETWEEN PERIODICALS BASED ON CONTENT.

The freedoms of press, speech and religion are in a preferred position. *Murdock v. Commonwealth of Pennsylvania*, 319 U.S. 105 (1943). All these interests must be aligned and analyzed in order to resolve the issues raised in this appeal.

Texas Monthly's Free Press and Free Speech claims regarding Texas Tax Code Section 151.312 are blended with its claims under the Equal Protection Clause. Texas Monthly argues that Section 151.312 grants or withholds a tax benefit and therefore discriminates based on a publication's content.

The two recent cases from this Court addressing tax impositions and the Free Press, Free Speech and Equal Protection Clauses are *Arkansas Writers' Project Inc. v. Ragland, supra, and Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, 460 U.S. 575 (1983). In these decisions, this Court intertwined the taxpayers' First Amendment claims with their interests under the Equal Protection Clause in reaching its decision.

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[2]Even if the Court decides its standing analysis is wrong, the Comptroller asserts Texas Monthly should not be entitled to recover the amount it paid if Section 151.312 is declared unconstitutional. By invalidating the exemption, the sales of religious periodicals become subject to tax. Texas Monthly would still be responsible for the tax and could not recover the amount it paid.

In *Arkansas Writers' Project*, religious, professional, trade and sports journals and/or publications printed and published within the state and sold through regular subscriptions were exempted from the Arkansas sales and use tax. General interest publications were not exempt. Arkansas Writers' Project published a general interest publication and paid the tax together with one or two other Arkansas publications.

The Minnesota Sales Tax Act in *Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, supra, exempted the sale of newspapers and other publications. It also exempted the first $100,000 of purchases of paper and ink products consumed in the production of publications but imposed a special use tax on purchases of paper and ink products exceeding $100,000 in a calendar year. The effect of the statute was that in 1974, 11 publishers, producing 14 of the 388 paid circulation newspapers in the state, paid the tax. In 1975, 13 publishers, producing 16 out of 374 paid circulation papers, paid the tax. The Star Tribune was one of the 11 and 13 publishers paying the tax and it paid two-thirds of the total revenue raised by the tax for each of the two years. Minnesota's special use tax was determined to be in violation of the First Amendment because it singled out the press for special treatment and because it also targeted a small group of newspapers. The court looked to the effect of the tax in deciding there was no satisfactory justification for it.

In *Arkansas Writers' Project*, the court found that selective taxation of the press, which it defined as either singling out the press as a whole or targeting individual members of the press, poses a danger of abuse by the state. The question in the case as noted by the court was whether the tax targeted a small group within the press. 107 S.Ct. at 1727. In deciding this question affirmatively, the court said: "Because

the Arkansas sales tax scheme treats some magazines less favorably than others, it suffers from the second type of discrimination identified in *Minneapolis Star*." 107 S.Ct. at 1727.

The court went on to state the case involved a more disturbing use of selective taxation; a magazine's tax status depends entirely on its content. Under the *Ragland* decision, the Comptroller asserts content discrimination applies to a tax provision only when the press is singled out to be subject to a tax or a small group of the press is targeted by a tax. The Texas Sales Tax Act taxes all magazines. It does not tax magazines based on their content. It exempts them on this basis, but only if they are periodicals published or distributed by a religious faith and consisting wholly of writings promulgating the teachings of the faith or books consisting wholly of writings sacred to a religious faith. Texas Tax Code Section 151.312.

During a part of the period in controversy, 20 to 30 magazine publishers paid an estimated amount of two million five hundred thousand dollars in tax ($2,500,000) to the State of Texas on magazine subscription sales. J.A. 99-101. This number is substantially in excess of the number of magazine or newspaper publishers in either *Arkansas Writers' Project or Minneapolis Star*.

The only two types of selective taxation identified in *Arkansas Writers' Project* are (1) singling out the press as a whole for different treatment and (2) targeting individual members of the press for taxation. The court clearly stated that the issue was whether the Arkansas tax targeted a small group within the press. Within the small group, content discrimination occurred and caused even more selective taxation violative of the First and Fourteenth Amendments.

Texas does not target a small group of magazines to subject them to tax on their magazine subscription sales. There is no selective content taxation of certain magazines by taxing all types of magazines and exempting one type.

There are at least two competing constitutional interests involved in this case, the press and religion. Previous cases have not addressed the issues presented in this appeal.[3]

The Austin Court of Appeals applied a rational basis standard in upholding the exemption in Tex. Tax Code Section 151.312. The court correctly used this standard since the exemption and not the tax is in issue and since the tax was general in nature and the exemption was an exception. A state legislature is not bound to tax every member of a class or none at all. The legislature may make distinctions of degree having a rational basis. An exemption, when subjected to judicial scrutiny, must be presumed to rest on a rational basis if any state of facts would support such basis. *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495 (1936).

Texas Monthly argues by assuming there is content discrimination that the Comptroller must prove "a compelling state interest" and must demonstrate that the statute is "narrowly drawn" to achieve that interest. Section 151.312 meets either a

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[3]As additional argument, the Comptroller submits that when a statute is challenged on the basis it favors religious speech, it should be analyzed only under the Free Exercise Clause and the principle of neutrality and not under other constitutional grounds. Cf. *Thomas v. Review Board of the Indiana Employment Security Division*, 450 U.S. 707 (1981). *Johnson v. Robison*, 415 U.S. 360 (1974). (Requiring neutrality only among religious as opposed to secular beliefs.)

rational basis or a compelling state interest test because this provision helps to accommodate religion, to reinforce the desired separation of church and state, it attempts to avoid an excessive entanglement with religion and it also attempts to avoid a violation of the Free Exercise Clause.

The State has a definite compelling interest in accommodating religion. Section 151.312 helps effectuate accommodation and is narrowly drawn.

A state has a compelling interest in not violating the Establishment or Free Exercise Clauses of the First Amendment of the United States Constitution, because these are preferred rights. "The course of constitutional neutrality in this area cannot be an absolutely straight line." *Walz v. Tax Commission*, 397 U.S. at 669.

In *Lemon v. Kurtzman*, supra, this court set out a three part test to determine whether a statute violates the Establishment Clause:

> First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion, ... finally, the statute must not foster "an excessive government entanglement with religion."

A statute violating the Establishment and Free Exercise Clauses is invalid in the same respect as is a statute violating the Equal Protection and Free Press and Free Speech Clauses. Texas has a rational basis for Section 151.312, which is to try to avoid violations of these provisions. If Section 151.312 is held unconstitutional, the compelling state interests it serves is to accommodate religion, to provide neutrality toward religion and to try to avoid violations of the

Establishment and Free Exercise Clauses. Section 151.312 is narrowly drawn to achieve that end.

Under the Establishment Clause, sponsorship, financial support and active involvement are to be avoided. According to *Walz v. Tax Commission*, 397 U.S. at 676, a tax exemption for religious property was determined to restrict the fiscal relationship between church and state and to reinforce a desired separation between them. The granting of such an exemption is not sponsorship because the state is not transferring part of its revenue to the church but simply abstaining from demanding the church support the state. 397 U.S. at 675. In other words, an exemption for religious publications allows the state to remain neutral toward religion. It neither advances nor inhibits religion. If an exemption for property of a religious group used exclusively for religious purposes does not advance or inhibit religion, certainly an exemption for periodicals consisting wholly of writings sacred to a religious faith would not. There is only a minimal involvement between the two but far less than taxation. The state has a definite compelling interest in remaining neutral in this area and Art. 151.312 helps effectuate that neutrality.

The exemption for religious periodicals does not create an excessive entanglement with religion. If sales of such periodicals were taxable and the seller became delinquent in the collection and payment of tax on these sales, the Comptroller of Public Accounts would under his normal collection process file tax liens against the property of the seller under Texas Tax Code Section 113.002 (Motion to Affirm or Dismiss, App. 4), issue notices to freeze money in bank accounts under Texas Tax Code Section 111.021 (Motion to Affirm or Dismiss, App. 5) and if property were owned by the seller, could by extra judicial procedures seize and sell the property to satisfy the tax debt pursuant to Texas

Tax Code, Section 111.017 (Motion to Affirm or Dismiss, App. 8). Elimination of the exemption would tend to expand the state's involvement in this area. *Walz v. Tax Commission*, 397 U.S. at 674.

Texas Monthly attempts to evade this argument by asserting that no general exemption for items sold by religious organizations exists and the spectre of tax liens and other collection procedures exist for sales of candles, crucifixes, canned goods or clothes even if the exemption for religious publications does not exist. In fact, however, the Texas Sales and Use Tax Act has a general exemption for the sale of food, meals, soft drinks and candy "by churches or at functions of churches." Texas Tax Code Section 151.314(e)(2). This exemption encompasses canned goods since they come within the definition of "food" in Section 151.314(c). Religious organizations can make a one day sale during a calendar year of any types of items without collecting the tax. (Motion to Affirm or Dismiss, App. 1) By exempting sales of food by churches and religious publications, the state has exempted items to be sold in large quantities and for larger amounts, which would occasion collection action for a tax collector.

In any case, it begs the issue to say that a spectre of tax collection action currently exists on other sales. If the state has the power, the problem is present. The Texas Legislature has the power to draw lines in the area of taxation. It has decided that in order to accommodate religion, it should grant an exemption for religious periodicals. The state should not be placed in the position of completely taxing religion or not taxing it at all. So long as the bases for its treatment are rational, and they are, they should be sustained.

Without the presence of Section 151.312, a violation of the Free Exercise Clause may occur.

Persons, such as Jehovah's Witnesses, are engaged in disseminating their message by selling religious publications door to door. The spreading of one's religious beliefs through distribution of religious literature is a type of evangelicism with a high claim to constitutional protection. *Murdock v. Commonwealth of Pennsylvania*, supra. A state tax levied and collected as a condition to the pursuit of this type of activity violates the Free Exercise and Free Press liberties of the First Amendment. 319 U.S. at 114. The Texas Sales and Use Tax Act without Section 151.312 would appear by its terms to place the same restraints and result in a constitutional violation.

These reasons serve as rational bases for the exemption appearing in Texas Tax Code Section 151.312 and also compelling state interests if it were declared unconstitutional.[4]

If this Court interprets *Ragland* as prohibiting the state on the basis of content discrimination from taxing publishers of all publications and from exempting religious publications at the same time, the Comptroller respectfully submits the decision cannot be reconciled with *Regan v. Taxation With Representation*, 461 U.S. 540 (1983), *Buckley v. Valeo*, 424 U.S. 1

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[4]The Comptroller respectfully submits that consideration should be given to the effect on periods beginning with October 1, 1987 if Section 151.312 is invalidated. Once invalidated, Section 151.312 would have no further legal existence. It was not re-enacted by the Texas Legislature to become effective October 1, 1987. If invalidated by this Court, beginning October 1, 1987, all subscription sales of magazines for a semi-annual or longer period and entered as second class mail would be exempt (Texas Tax Code 151.320); however, sales of religious periodicals would be taxable. Even if some religious periodicals might qualify for the magazine subscription sales exemption, others would not. Subsequent content based discrimination would result from attempting to correct previous content based discrimination.

(1976), and *Harris v. McRae*, 448 U.S. 297 (1980) and should be overruled for the reasons discussed by Justice Scalia in his dissent in *Arkansas Writers' Project Inc. v. Ragland*, supra.[5]

III. SECTION 151.312 DOES NOT CONSTITUTE A "LAW RESPECTING AN ESTABLISHMENT OF RELIGION."

The Court of Appeals noted in its decision that Texas Monthly addressed the Establishment Clause of the First Amendment but only as part of its Equal Protection analysis. J.S. App. 3. Texas Monthly now raises the separate argument that Section 151.312 per se violates the Establishment Clause of the First Amendment. The decision of the state court will not for that reason relate to Texas Monthly's arguments before this court.

The Constitution affirmatively mandates accommodation, not merely tolerance, of all religions and forbids hostility toward any. *Lynch v. Donnelly*, 104 S.Ct. 1355, 1359 (1984). Accommodation is not just permitted but is required. Where the aim of a statute is to accommodate religion, the tests in *Lemon* should not be rigidly applied so accommodation can be accomplished. If this accommodation is not afforded, there may be intrusion on the state's interest in promoting the First Amendment's guaranty of free exercise of religion. 104 S.Ct. at 1359.

Section 151.312 meets the three part test set out in *Lemon v. Kurtzman* to determine whether a statute

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[5]The hazards of an overbroad reading of *Arkansas Writers' Project*, which Justice Scalia predicted, have occurred. 107 S.Ct. at 1732. See *Bullfrog Films Inc. v. Wick*, No. 86-6630 (9th Cir. May 17, 1988.)

violates the Establishment Clause. First, the Section has a secular legislative purpose: to accommodate religion, be neutral toward it, not promote it. This Court has invalidated legislation on the ground a secular purpose was lacking only when it has concluded there was no question that the statute was motivated wholly by religious considerations. *Lynch v. Donnelly*, 104 S.Ct. at 1362.

The secular purpose requirement is aimed at preventing the government from abandoning neutrality and acting with the intent of promoting a particular point of view in religious matters. *Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints et al v. Christine Amos,*. 107 S.Ct. 2862, 2868 (1987). The purpose of Section 151.312 is neutrality toward religion. Although the broader exemption in *Walz* provides a clearer case of nonsponsorship than Section 151.312, the neutrality toward religion effected by the grant of this exemption is just as evident.

The exemption does not have the primary effect of advancing or inhibiting religion ("effects test"). It creates under *Walz* only a "minimal and remote involvement between church and State and far less than taxation of churches." 397 U.S. at 677. In *Walz* this Court held *"There is no genuine nexus between tax exemption and establishment of religion."* 397 U.S. at 677 (emphasis supplied).

The fact religion may receive an unintended benefit does not mean Section 151.312 is advancing religion. The supplying of costly teaching materials is not a legislative aid to religion. 397 U.S. at 672. See *Board of Education of Central School Dist. No. 1 v. Allen*, 392 U.S. 236, 248 (1968). If these materials are not an aid to religion, an exemption for sales of religious periodicals should not be classified as such.

In *Corporation of the Presiding Bishops of the Church of Jesus Christ of the Latter-Day Saints et al v. Christine Amos*, 107 S.Ct. at 2869, the Court found unpersuasive the lower court's reliance on the fact the statute in issue singled out religious entities for a benefit. It held that although the court had given weight to this consideration in the past, it had never indicated that statutes that give special consideration to religious groups are per se invalid. "That would run contrary to the teaching of our cases that there is ample room for accommodation of religion under the Establishment Clause." 107 S.Ct. at 2869.

The question is whether the principal or primary effect of Section 151.312 is to advance religion. *Tilton v. Richardson*, 403 U.S. at 679. "But bus transportation, textbooks, and tax exemptions all gave aid in the sense that religious bodies would otherwise have been forced to find other sources from which to finance these sources. Yet all of these forms of governmental assistance have been upheld." 403 U.S. at 679. Section 151.312 likewise does not have the primary effect of advancing religion.

After a determination is made, if any, regarding the entitlement to the exemption, there is no further involvement between the State and the church. The government may accommodate religious practices without violating the Establishment Clause. *Hobbie v. Unemployment Appeals Commission of Florida et al*, 107 S.Ct. 1046, 1051 (1987). The testimony indicates the agency administering the tax, the Comptroller of Public Accounts, interprets Section 151.312 in such a manner that the parties to the sale transaction make the decision on whether the sale is exempt under Section 151.312. A law is not unconstitutional simply because it allows churches to advance religion. "But religious groups have been better able to advance their

purposes on account of many laws that have passed constitutional muster: for example, the property tax exemption at issue in *Walz v. Tax Comm'n*, supra, or the loan of school books to school children." Cor*poration of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints et al v. Christine Amos*. 107 S.Ct. at 2868.

An important concern of the effects test is "whether the symbolic union of church and state effected by the challenged governmental action is sufficiently likely to be perceived by adherents of the controlling denominations as an endorsement and the nonadherents as a disapproval, of their individual religious choices." *Grand Rapids School District v. Ball*, 105 S.Ct. 3216, 3226 (1985). A program of releasing students to attend voluntary religious instruction off premises of a public school did not have a symbolic union reflecting an endorsement of religion. *Zorach v. Clauson*, 343 U.S. 306, 313-314 (1952). A provision exempting the voluntary purchase or sale of all religious periodicals likewise does not present a symbolic union endorsing religion.

A tax exemption has been called a form of subsidy. Although like a cash subsidy it is not identical to a cash subsidy. *Regan v. Taxation With Representation of Washington*, 461 U.S. at 543. Tax deductions encompassing exemptions from property tax for property used for wholly religious purposes may benefit substantially religious institutions. "The Court's holding in *Walz v. Tax Comm'n* indicates, however, that this does not require the conclusion that such provisions of a state's tax law violate the Establishment Clause." *Mueller v. Allen*, 463 U.S. at 396.

The third test is whether the statute creates an excessive entanglement with religion. Texas Monthly

asserts the statute on its face requires excessive government entanglement with religion because it requires the state to determine (i) whether the publisher or distributor is a "religious faith" and (ii) whether the contents of the publication consist "wholly of writings promulgating the teachings of the faith."

Section 151.312 does not create an excessive entanglement with religion. This Court in *Walz v. Tax Commission*, supra, determined that a property tax exemption for property owned by a religious organization and used exclusively for religious purposes did not create an excessive entanglement with religion. If having to determine whether property is being used exclusively for religious purposes does not cause an excessive entanglement to exist, then determining whether a publisher is a religious faith and the contents of the publication are wholly writings promulgating the teaching of that faith should be no more a violation.

In *Board of Education of Central School Dist. No. 1 v. Allen*, supra, and *Mueller v. Allen*, supra, the loan of secular textbooks to parents or children attending nonpublic schools, though state officials were required to determine whether particular books were or were not secular, was held not to violate the entanglement test under the Establishment Clause. In making their decision, the state officials were required to review content of publications. There was no continuing state surveillance present in merely reviewing the contents of the publications. *Mueller v. Allen*, 463 U.S. at 403.

The only possible difference Texas Monthly could assert between the Section 151.312 review and the review in these cases would be one of time interval-frequency. In the case of school books, the review

would probably be once a year; where as, religious publications might be more frequent. This distinction has no substance. From the view of a tax administrator, it would be impractical to have to make too many reviews of a publication. The cost of administration for such an exemption could not be justified.

In determining whether there has been entanglement, the implementation of the statute by the agency administering Section 151.312 and its adoption by the state court should be considered. Ms. Wanda Hutcheson, Supervisor for Sales Tax Policy for the Office of the Comptroller of Public Accounts, testified to the Comptroller's administration of Section 151.312:

> Q. And that there is no system to submit a magazine to you to determine whether it's exempt or not, is there?
>
> A. Other than just sending it in, no, sir.
>
> Q. Has that happened?
>
> A. Magazines, not to my knowledge.
>
> Q. What's been sent in?
>
> A. I think what is sent in normally is the organization itself will give us the name of what is being published and ask us if that particular publication qualifies for a sales tax exemption.
>
> Q. And you decide?
>
> A. No, sir. What we normally do is to see if the organization itself is a religious organization.

Q. And if the religious organization anything they publish you let come out under that exemption?

A. What we tell them is we leave it to (p. 72) them to decide whether or not it's a religious a publication or periodical that teaches their faith. We do not make that determination.

Q. Because there's no you don't have any authority to make it in advance of somebody trying to collect the tax from them?

A. Well, I think it's mainly just because we don't want to get involved in deciding whether something is sacred to a religious faith or not.

Q. But if I go out and say I'm a religious faith and I want to publish a magazine that, I say, is sacred to me and I publish it, I don't have to come to you and get an exemption? I just start publishing it?

A. That's correct. After it's been established that you are, in fact, a religious organization, we do not pursue it any further.

Q. And if it's a religious -- and you decide on whether it's religious or not?

A. Tax administration does, yes, sir.

Q. And that's something they look at what people say and how they act and what they do to determine whether they're, quote, a religious faith?

> (p. 74) A. There are some guidelines that are set up to determine whether or not an organization is--qualifies as a religious organization.
>
> J.A. 60-61

The Comptroller's policy has been in effect for at least 12 years. J.A. 416-417. Under Texas law when a statute is ambiguous, the agency construction of the statute should be followed. *Federal Crude Oil Co. v. Yount Lee Oil Co.*, 122 Tex. 21, 52 S.W.2d 56, 62 (Tex. 1932), *Lumbermen's Underwriters v. State Board of Insurance*, 502 S.W.2d 217, 220 (Tex. Civ. App.-- Austin 1973, writ ref'd n.r.e.); and *Davis Kemp Tool Co. Inc. v. Bullock*, 584 S.W.2d 579 (Tex. Civ. App. Beaumont, writ ref'd n.r.e.) per curiam, 590 S.W.2d 708 (Tex. 1979). The provisions of Section 151.312 are ambiguous. What is a book consisting wholly of writings sacred to a religion or religious faith? In recognition of this ambiguity, the Comptroller has not attempted to decide what publications qualify under Section 151.312. The Comptroller's construction should be accepted under existing state law. It is a reasonable construction of the exemption and one that does not involve an excessive entanglement with religion.

Although the agency construction of Section 151.312 does not appear in its rule (34 Tex. Admin. Code Section 3.299(d)), State law is that an agency's interpretation of its own rule is to be considered part of the rule. *Texarkana and Ft. S. Ry. Co. et al v. Houston Gas & Fuel Co.*, 121 Tex. 594, 51 S.W.2d 284, 287 (1932); *Lawyers Title Ins. Corporation v. Board of Ins. C[illegible]n'rs et al.* 207 S.W.2d 972, 976 (Tex. Civ. App.-- Austin 1948, writ ref'd n.r.e.). The State court was properly entitled to rely on the agency construction.

In summary, due to its passive nature, Section 151.312 does not create the ongoing partnership between the State and religion presented by direct aid. Once the sale of the publication is determined to be exempt there is no further action needed by the state or religion. The nature of the exemption is such that the comprehensive and continuing state surveillance forbidden in *Lemon v. Kurtzman*, supra, is not present. Further, the administration of Section 151.312 prevents state involvement.

Article 151.312 meets all three tests and is constitutional.

CONCLUSION

The Comptroller respectfully submits that Texas Monthly does not have standing to attack Tex. Tax Code Section 151.312 and respectfully moves the Court to dismiss the appeal, or, in the alternative, to affirm the judgment entered in the cause by the Court of Appeals, Third Supreme Judicial District, Austin, Texas, or further in the alternative, if this Court determines Section 151.312 is unconstitutional, to invalidate this Section and deny recovery to Texas Monthly.

Respectfully submitted,

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FOR ARGUMENT No. 87-1245

In The
Supreme Court of the United States
October Term, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

REPLY BRIEF

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No. 87-1245

In The

Supreme Court of the United States

October Term, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

REPLY BRIEF

The issue of standing raised by appellees in their brief was fully addressed by this Court in *Arkansas Writers' Project, Inc. v. Ragland*, 107 S.Ct. 1722, 1726 (1987). There, the publisher of a non-exempt magazine challenged the constitutionality of a statute exempting from a general sales tax only "religious, professional, trade and sports journals." The Arkansas Commissioner of Revenue argued that the non-exempt publisher lacked standing because, even if the exemption were held unconstitutional, the appropriate remedy, as held by the Arkansas Supreme

Court, would be to strike the exemption and not the tax. Since a favorable decision of the Court would not relieve the publisher of its tax burden, the requirements for standing set forth in *Valley Forge Christian College v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464 (1982), would not be met.

The Court rejected the standing argument:

> We do not accept the Commissioner's notion of standing, for it would effectively insulate underinclusive statutes from constitutional challenge, a proposition we soundly rejected in *Orr v. Orr*, 440 U.S. 268, 272, 99 S.Ct. 1102, 1108, 59 L.Ed.2d 306 (1979).

107 S.Ct. at 1726. Holding that the non-exempt publisher had standing to challenge the statute, the Court considered the merits, held the exemption unconstitutional and invalidated the tax. *Id.* at 1730.[1] *Arkansas Writers' Project* is consistent with other cases in which the Court has held that underinclusive statutes placed an unconstitutional burden on free speech. The Court has relieved speech from the impermissible burden rather than extend the burden to a broader category of speech. *See, e.g., Carey v. Brown*, 447 U.S. 455 (1980) (statute prohibiting all picketing except peaceful labor picketing unconstitutional; entire statute invalid); *Police Department of Chicago v. Mosley*, 408 U.S. 92 (1972) (statute prohibiting picketing in front of schools unless related to labor dispute unconstitutional;

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[1]The Court held the tax invalid even though the Arkansas Supreme Court had stated that under state law the proper remedy would be to strike the exemption and not the tax. *Ragland v. Arkansas Writers' Project, Inc.*, 287 Ark. 155, 698 S.W.2d 802, 803 (1985).

entire statute invalid). *See also Armco Inc. v. Hardesty*, 467 U.S. 638 (1984) (exemption from tax for in-state manufacturers held unconstitutional; tax on out-of-state manufacturers invalid).

The Texas statute, like the one in *Arkansas Writers' Project*, is an underinclusive one, exempting from a general sales tax only those "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith." Texas Monthly has asserted a personal stake in the outcome of this litigation. It has remitted to the State substantial sales tax imposed because of the content of its periodical which can be recovered only by challenging the underinclusive exemption. The instant case is indistinguishable from *Arkansas Writers' Project*.

Appellees assert that there is a basis for distinguishing *Arkansas Writers' Project*. Subscription sales of periodicals became exempt from the Texas sales tax effective October 1, 1987 while the Arkansas tax was still in effect during the appeal. This fact does not affect standing for two reasons. First, Texas Monthly has been required to remit substantial sums in taxes to the State because of the *content* of its magazine. The penalty on speech remains a harsh one regardless of whether subscription sales continue to be taxed. Second, Texas Monthly's newsstand sales continue to be taxed while similar sales of religious periodicals are exempt. The competitive harm of the content-based unequal treatment of magazines still exists.[2]

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[2]Further, contrary to appellees' argument, state law mandates a refund of taxes paid by Texas Monthly rather than an extension

(Continued on following page)

CONCLUSION

For the reasons stated here and in the Brief for Appellant, the judgment of the Texas Court of Appeals should be reversed and the judgment of the district court affirmed.

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(Continued from previous page)

of the tax to religious periodicals. The district court so held, awarding Texas Monthly all taxes it had paid under protest. J.S. App. 43. The Court of Appeals did not reach the issue. *See Pullman P.C. Co. v. State*, 64 Tex. 274 (1885) (striking tax, not exemption; courts cannot amend legislation to extend tax to group legislature intended to exempt); *Hurt v. Cooper*, 113 S.W. 2d 929, 941 (Tex. Civ. App.—Dallas 1938, no writ) (court may not impose tax on exempted subjects but may relieve taxpayers upon whom burden imposed; saving provision or severability clause does not change this result).

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No. 87-1245

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

TEXAS MONTHLY, INC.,
Appellant,

v.

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS, AND ANN RICHARDS, TREASURER OF THE STATE OF TEXAS,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF OF THE MAGAZINE PUBLISHERS OF AMERICA, INC., *AMICUS CURIAE*

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-1245

TEXAS MONTHLY, INC.,

Appellant,

v.

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS, AND ANN RICHARDS, TREASURER OF THE STATE OF TEXAS,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* OF THE MAGAZINE PUBLISHERS OF AMERICA, INC., *AMICUS CURIAE*

Movant is a national trade association of magazine publishers who publish more than 900 magazines. The written consent of the appellant, Texas Monthly, Inc., has been obtained and filed with the clerk of this Court. The consent of the appellee has been requested and refused.

Movant seeks to submit a brief *amicus curiae* because it shares with appellant a vital interest in the outcome of this proceeding. The imposition of the Texas sales tax on appellant's and most other publications, but not on certain religious publications, impermissibly abridges appellant's rights and involves the state in the advancement of a religious faith in violation of the First and Fourteenth Amendments to the Constitution of the United States.

Movant requests this Court to grant leave to file its accompanying brief *amicus curiae* to present its views to this Court urging reversal of the opinion of the court below.

/s/

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ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

BRIEF OF THE MAGAZINE PUBLISHERS OF AMERICA, INC., *AMICUS CURIAE*

INTEREST OF *AMICUS CURIAE*

The Magazine Publishers of America, Inc. (MPA), is a national trade association including in its membership more than 200 magazine publishers who publish about 900 magazines sold at newsstands and by subscription. MPA members provide broad coverage of domestic and international news in weekly and biweekly publications, and publish weekly,

biweekly and monthly publications covering literature, religion, law, political affairs, science, agriculture, industry and many other interests, avocations, and pastimes of the American people.

MPA shares with Texas Monthly, Inc., and others a commitment to exercise and preserve First Amendment liberties protected by the Constitution and this Court, as well as a common conviction that the decision of the Texas Court of Appeals upholding the constitutionality of the sales tax as it applies to most publications but not to religious publications abridges the Freedoms of Speech and of the Press of all but the exempt, and advances the cause of a religious faith in violation of the establishment clause of the First Amendment.

SUMMARY OF ARGUMENT

In upholding the constitutionality of the Texas retail sales tax, which applied to the sale of all publications except publications consisting wholly of religious writing published or distributed by a religious faith, the Texas Court of Appeals misread this Court's decision in *Arkansas Writer's Project v. Ragland*, 481 U.S. ____; 95 L.Ed. 2d 209 (1987). The Texas Court interpreted *Arkansas Writer's Project* to apply only to cases where the press is singled out for taxation or where a small number of publications are subject to taxation. That narrow view ignores this Court's principal reason for striking down the Arkansas tax: the Arkansas tax discriminated on the basis of the content of the publication. The Texas statute is identical to the Arkansas statute in that it exempts a class of publications from taxation *based on the content of the publication.* The Texas court also erred in finding a secular purpose in the exemption of religious publications. A secular purpose cannot be present when the *only*

purpose of legislation is to exempt religious publications from taxation, thereby violating the establishment clause of the First Amendment and impermissibly involving the state in the advancement of a religious faith.

ARGUMENT

Following a trial in February, 1986, the District Court of Travis County, Texas, held that section 151.312 of the Texas Tax Code, exempting certain religious publications from the payment of sales taxes, "constitutes an unlawful discrimination based on the content of [Texas Monthly's] publication in violation of its rights under the First and Fourteenth Amendments" of the Constitution of the United States. On appeal, the Texas Court of Appeals reversed, holding that the statute did not discriminate in violation of the plaintiff's right of free speech, but merely served to protect the church and church publications from governmental interference. After this Court issued its opinion in *Arkansas Writer's Project v. Ragland*, decided April 22, 1987, the Texas court withdrew its initial opinion and issued a second opinion. Addressing Appellant's argument that this Court's decision in *Arkansas Writer's Project* applied to the case before the court, the court said:

> The Supreme Court determined that the tax exemption in *Ragland* was so broad that it had the effect of singling out a very small group of magazines for *taxation*. This appeal, to the contrary, presents the opposite situation. The great mass of publishers remain subject to the sales tax. The Legislature has rationally determined to *exempt* religious publications as a means of furthering the separation of church and state. Neither of the situations deemed objectionable by the Supreme Court in *Ragland* is presented in this appeal. 731 S.W.2d 160, 165.

We respectfully suggest that the Texas court stopped reading too soon. After making the point that the Arkansas tax applied to "only a few" magazines (which the Texas court found to be decisive), this Court went beyond its earlier decision in *Minneapolis Star & Tribune v. Minnesota Commissioner of Revenue*, 460 U.S. 575 (1983):

> Indeed, this case involves a more disturbing use of selective taxation than Minneapolis Star because the basis on which Arkansas differentiates between magazines is particularly repugnant to First Amendment principles: a magazine's tax status depends entirely on its *content*. "[A]bove all else, the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, or its content." [Citations omitted] 481 U.S. ____; 95 L.Ed.2d 220.

The method selected by the Texas legislature to tax publications is content-based, the approach struck down by this Court in *Arkansas Writer's Project*. The Texas legislature exempted only periodicals "published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith. . . ." Texas Tax Code, §151.312. A more conspicuous example of content-based discrimination is hard to imagine. It is precisely the kind of tax discrimination found unconstitutional in *Arkansas Writer's Project*.

In examining whether Arkansas's exemption of religious and other publications from the sales tax was justified, this Court laid down a difficult course:

> Arkansas faces a heavy burden in attempting to defend its content-based approach to taxation of magazines. In order to justify such differential taxation, the State must show that its regulation is necessary to serve a compelling state interest and

> is narrowly drawn to achieve that end.
> [Citation omitted] 481 U.S. ____; 95 L.Ed.2d 221.

The Texas court imposed no such burden. Instead, relying on *Carmichael v. Southern Coke and Co.*, 301 U.S. 495 (1936) and *Madden v. Kentucky*, 309 U.S. 83 (1940), the Texas court applied the far less stringent "rational legislative purpose," standard for testing the validity of the tax exemption, and imposed upon the appellant the burden "to negate every conceivable basis which might support" the tax discrimination. Obviously, as this Court made clear in *Minneapolis Star* and *Arkansas Writer's Project*, where First Amendment issues are involved, a much higher standard is necessary to sustain government infringement and the burden to justify the infringement rests upon the state. The court below did not apply those mandates.

Responding to appellant's argument that the exemption constitutes a law "respecting an establishment of religion" in violation of the First Amendment, the Texas court compared the exemption to the three-part test prescribed in *Lemon v. Kurtzman*, 403 U.S. 602 (1971):

> First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion, . . . finally, the statute must not foster "an excessive entanglement with religion." 403 U.S. 612-613

The Texas court found that the exemption has a "secular legislative purpose", that purpose being to ensure the neutrality of state action. We disagree; a statute that grants a tax exemption *only* to religious publications has *no* secular purpose. Neutrality is achieved not by granting preferences, but by treating all alike. The primary effect of exemption from taxation is to relieve the beneficiary from the burden of pay-

ing taxes, and when the only beneficiaries are the publishers of publications promulgating a religious faith, the inevitable effect of the exemption is to advance the cause of the religion espoused. Notwithstanding the protestations of the Comptroller's witness, the Comptroller *must* become "entangled". A religious faith is a "belief" not an enterprise. Merely to determine whether a corporation, association, or trio is a "religious faith" as the legislature envisioned involves analysis and judgment. Unless the Comptroller abandons his constitutional responsibility to the people of Texas to administer, faithfully, the Texas Tax Code, he must determine whether a particular organization is a "religious faith" and whether particular writings promulgate "the teaching of the faith." Should he magically achieve this elusive goal without becoming entangled in the nuances of "faith" and "promulgation," the Texas exemption still fails two of the three *Lemon* tests: the exemption serves no purpose except to exempt religious publications from taxation, and that exemption necessarily advances the advocacy of a religion.

CONCLUSION

We respectfully urge this Court to reverse the decision of the Texas Court of Appeals and return the case for the lower court to order appellees to refund the taxes paid under protest.

Respectfully submitted,

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IN THE

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BOB BULLOCK, *et al.*,

Appellees.

ON APPEAL FROM THE
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BRIEF *AMICUS CURIAE* OF THE AMERICAN CIVIL LIBERTIES UNION, THE TEXAS CIVIL LIBERTIES UNION, THE AMERICAN JEWISH CONGRESS AND THE ANTI-DEFAMATION LEAGUE OF B'NAI B'RITH IN SUPPORT OF APPELLANT

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INTEREST OF AMICI[1/]

The American Civil Liberties Union (ACLU) is a nationwide, non-partisan organization with over 250,000 members dedicated to defending the principles of individual liberty embodied in the Constitution. The Texas Civil Liberties Union is one of its state affiliates.

A central tenet of the ACLU since its founding nearly 70 years ago is that the government must remain neutral in matters of individual conscience. Thus, the free speech clause of the First Amendment prohibits the government from favoring one publication over another because of its content. Likewise, the establishment clause of the First Amendment prohibits the

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1/ Letters of consent to the filing of this brief have been lodged with the Clerk of the Court pursuant to Rule 36.2.

government from favoring religion over non-religion except in very limited circumstances. By granting religious periodicals a special exemption from the state sales tax, Texas has violated both of these principles.

The American Jewish Congress is a membership organization of American Jews founded in 1918 which seeks to protect the religious, political and economic rights of Jews and to promote civil rights and liberties for all Americans. The American Jewish Congress is particularly committed to the great freedoms secured by the First Amendment which ensure government neutrality with respect to religion and which bar government from subsidizing religious speech because of its content.

The Anti-Defamation League of B'nai B'rith was organized in 1913 to advance

good will and mutual understanding among Americans of all creeds and races, and to combat racial and religious prejudice in the United States. The Anti-Defamation League has always adhered to the principle that the above goals and the general stability of our democracy are best served through the separation of church and state and the right to free exercise of religion.

Amici submit this brief in support of appellant, and urge this Court to reverse the decision below.

STATEMENT OF THE CASE

This case challenges the constitutionality of a Texas statute that confers a unique and valuable benefit on religion by relieving religious periodicals, and only religious periodicals, of any obligation to pay the state sales tax. Specifically, §151.312 of the Texas Tax Code provides:

> Periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religion or religious faith are exempted from the taxes imposed by this Chapter.

Appellant Texas Monthly is a general interest magazine that is neither "published [n]or distributed by a religious faith." Without the benefit of the tax exemption available to religious periodicals, it paid (under protest) approximately $150,000 in state sales tax for the eleven

month period between January and December 1985. Bullock v. Texas Monthly, Inc., 731 S.W.2d 160, 162 (Tx.Ct.App. 1987). It then brought suit seeking restitution on two separate but related constitutional theories.

First, appellant contended that its tax liability could not be determined by the content of its magazine under well-settled principles of First Amendment law. That claim was rejected by the court below on the purported authority of Regan v. Taxation with Representation, 461 U.S. 540 (1983). On rehearing, the Texas Court of Appeals also rejected the relevance of Arkansas Writers' Project v. Ragland, 107 S.Ct. 1722 (1987). As construed by the court below, Ragland only applies when a small group of magazines is singled out for taxation based on content, and does not

apply when a small group of magazines is singled out for a tax exemption based on content. 731 S.W.2d at 165.

Second, appellant argued that the state's decision to grant preferential tax status to religious periodicals violated the establishment clause. This claim, as well, was rejected below in a discussion that rested almost entirely on this Court's decision in Walz v. Tax Commission, 397 U.S. 664 (1970).

SUMMARY OF ARGUMENT

The central teaching of the First Amendment is that the government must remain neutral in matters of individual conscience. E.g. Wallace v. Jaffree, 472 U.S. 38, 50 (1985). That principle is expressed in a variety of specific First Amendment doctrines, two of which are particularly relevant here. In matters of speech, the government is generally barred from drawing distinctions based on content. In matters of faith, the government is generally barred from favoring religion over those who pursue a more secular vision of society.

Both these doctrines are the product of long and bitter experience; both are deeply embedded in our national heritage; and both were violated by the decision below. Moreover, the decision below seri-

ously misinterpreted several recent decisions by this Court reaffirming the constitutional principle of government neutrality under the First Amendment.

This Court has been especially vigilant in ensuring that the government's power to tax does not become a weapon for censorship. Thus, this Court has repeatedly and consistently struck down taxing schemes that either penalize or reward taxpayers because of the content of their speech. See Arkansas Writers' Project v. Ragland, supra; Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue, 460 U.S. 575 (1983); Grosjean v. American Press, 297 U.S. 233 (1936).

Contrary to the view of the court below, Regan v. Taxation with Representation ("TWR") is entirely consistent with this line of cases. In TWR, the Court

carefully emphasized that the special tax benefit granted to veterans' groups was tied to their status and not to the content of their lobbying program. Here, by contrast, the challenged tax exemption turns solely on questions of content.

Furthermore, the content-based judgments compelled by §151.312 have only one purpose: to grant a preference to religious periodicals. That purpose is inconsistent with the most basic premises of the establishment clause. Edwards v. Aguillard, 107 S.Ct. 2753 (1987). In addition, the statute has the effect of promoting religion, and encouraging an excessive entanglement between church and state. Lemon v. Kurtzman, 403 U.S. 602 (1971). Nor can the specter of entanglement be avoided by delegating to religion the right to decide whether the criteria

for tax exemption have in fact been met. See Larkin v. Grendel's Den, 459 U.S. 116 (1982).

Finally, Walz v. Tax Commission cannot be read as a blanket endorsement of any tax scheme benefiting religion. In Walz, the Court upheld a property tax exemption that religious organizations shared with other charitable groups. The Court has never upheld a tax exemption targeted at religion alone. Even if such a targeted benefit is not per se unconstitutional, it cannot be sustained unless necessary to accommodate a substantial free exercise claim. In this case, there is none. Cf. Corporation of Presiding Bishop v. Amos, 107 S.Ct. 2862 (1987).

I. A STATUTORY SCHEME THAT AWARDS TAX BENEFITS TO CERTAIN MAGAZINES BUT NOT TO OTHERS BASED ON CONTENT VIOLATES THE FIRST AMENDMENT

Under Texas law, a magazine that consists "wholly of writings promulgating" the religious faith of its publisher is exempt from the sales tax that other periodicals must pay. On its face, this statutory scheme violates the obligation of content-neutrality imposed by the First Amendment.

As this Court has frequently noted:

> [A]bove all else, the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, or its content.

Police Dep't of Chicago v. Mosley, 408 U.S. 92, 95 (1972). Thus, "[r]egulations which permit the Government to discriminate on the basis of the content of the message cannot be tolerated under the First Amend-

ment." Regan v. Time, Inc., 468 U.S. 641, 648-49 (1984). See also Boos v. Barry, 108 S.Ct. 1157 (1988); Carey v. Brown, 447 U.S. 455 (1980).

This Court has been especially sensitive to charges of selective taxation based on content. The explanation for that concern is obvious. "A power to tax differentially, as opposed to a power to tax generally, gives a government a powerful weapon against the taxpayer selected." Minneapolis Star, 460 U.S. at 585.

Reflecting that concern, this Court has never upheld a differential tax scheme based on the content of a publication. The issue has come to the Court three times over a period of nearly fifty years, and on each occasion the Court has ruled in favor of the taxpayer on First Amendment grounds. See Arkansas Writers' Project v. Ragland,

supra; Minneapolis Star, supra; Grosjean v. American Press, supra.

The Court's most recent holding, in Ragland, succinctly summarizes the well-settled law in this area:

> [T]he basis on which Arkansas differentiates between magazines is particularly repugnant to First Amendment principles: a magazine's tax status depends entirely on its content.

107 S.Ct. at 1727 (emphasis in original).

The decision by the Texas Court of Appeals attempts to distinguish Ragland on the ground that the state in that case had chosen to tax a "small group" of publishers whereas here the "great mass of publishers remain subject to the sales tax." 731 S.W.2d at 165. It is not exactly clear why the court below found this distinction meaningful. In any event, it is flawed both descriptively and theoretically.

Like most affirmative/negative distinctions, the line drawn by the court below is mostly a matter of perspective. Instead of focusing on the "great mass of publishers who remain subject to the sales tax" in Texas, the court could just as easily have focused on the "small group" of publishers who are exempt from the tax.

Presumably, the court meant to suggest that the likelihood of a punitive tax decreases as the size of the taxed group increases. However, that assumption is irrelevant even assuming it is valid.2/ As this Court stated in Minneapolis Star, 460 U.S. at 592, and repeated in Ragland, 107 S.Ct. at 1727, "[i]llicit legislative intent is not the sine qua non of a viola-

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2/ In both Grosjean and Minneapolis Star, the state's largest newspapers were in the "small group" of publications subject to a discriminatory tax.

tion of the First Amendment." For similar reason, this Court has not required evidence of viewpoint discrimination in this context. Ragland, 107 S.Ct. at 1728.

The effort by the court below to draw an analogy between this case and Regan v. Taxation with Representation is equally flawed. In TWR, the Court upheld a provision of the federal tax code that permits veterans' organizations to lobby with tax exempt dollars although other charitable groups are denied a similar benefit. Unlike the statute in this case, however, the statute in TWR was content-neutral.

Moreover, the Court emphasized precisely that point, noting that "the veterans' organizations that qualify under [the statute] are entitled to receive tax-deductible contributions regardless of the content of any speech they may use,

including lobbying." 461 U.S. at 548. In short, their favorable tax treatment was a function of who they were, not what they said. Id. at 550-51.3/

The Texas statute, by contrast, is undeniably content-based. Religious publications are not automatically entitled to a tax exemption regardless of what they print. The exemption is only available if the publication consists "wholly" of religious writings. That determination plainly cannot be made without examining the contents of each specific issue and article.

Under the circumstances, Texas "faces a heavy burden in attempting to defend its

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3/ The court below also cited TWR for the proposition that the First Amendment does not guarantee a right to have one's speech subsidized by the government. 731 S.W.2d at 165. That proposition, however, is not in dispute here. Texas Monthly claims only the right to be free from discrimination because of the content of its message.

content-based approach to taxation of magazines." Ragland, 107 S.Ct. at 1728. Having employed the wrong legal analysis, the court below also employed the wrong legal standard. Rather than the strict scrutiny demanded by this Court's decisions in Ragland and Minneapolis Star, the decision of the Texas Court of Appeals is so deferential in its standard of review that it does not even pause to identify -- let alone examine -- the interests asserted by the state in support of the challenged statute.

In reviewing possible justifications for the Texas statute, this Court is not writing on a clean slate. The desire to raise additional revenue for the state is clearly insufficient to justify a scheme of differential taxes based on the content of protected speech. Ragland, 107 S.Ct. at

1728-29; Minneapolis Star, 460 U.S. at 586. And for reasons more fully described in the following section, the desire to favor religion through the distribution of favorable tax benefits is clearly prohibited by the establishment clause. Finally, Texas' benevolent attitude toward religion cannot be described as necessary to preserve free exercise rights since there is no free exercise right to a tax exemption. United States v. Lee, 455 U.S. 252 (1982).

In short, there is no compelling justification adequate to support the challenged statute. Under Ragland and Minneapolis Star, it must be struck down.

II. THE ESTABLISHMENT CLAUSE IS VIOLATED BY A STATE STATUTE THAT SINGLES OUT RELIGION FOR FAVORABLE TAX TREATMENT

Section 151.312 offends the neutrality principle of the First Amendment in a second fundamental sense. By requiring state officials to make content-based judgments in administering the tax laws, it violates the free speech clause of the First Amendment. By singling out religion as the only subject matter entitled to favorable tax treatment, it also violates the establishment clause.

This point was aptly summarized by the dissenting opinion of Justice Carroll in the Texas Court of Appeals:

> Special tax benefits given only to religions cannot be squared with the principle of neutrality, and such laws have the inevitable effect and purpose of aiding and advancing only those benefited religious organizations.

731 S.W.2d at 169 (emphasis in original).

In response to appellant's establishment law challenge, the majority below relied almost entirely on Walz v. Tax Commission, 397 U.S. 664 (1970). Walz, however, is readily distinguishable. The New York statute at issue in Walz did not single out religion for favored treatment. Rather, the question before the Court was whether religious organizations should be disabled from receiving a tax benefit otherwise available to a broad range of charitable groups. 397 U.S. at 672-73.

This distinction is a crucial one and has been emphasized by the Court in numerous decisions. For example, in Mueller v. Allen, 463 U.S. 388 (1983), the Court upheld a Minnesota statute permitting parents to deduct certain educational expenses even if those expenses were incurred for religious education. The deci-

sion turned, in large measure, on the Court's observation that "the deduction is available for educational expenses incurred by all parents . . . ." Id. at 397 (emphasis in original). See also Witters v. Washington Dep't of Services for the Blind, 474 U.S. 481 (1986).

By contrast, in Committee for Public Education v. Nyquist, 413 U.S. 756 (1973), the Court struck down a system of tuition grants that were only available to parents of children in non-public schools.4/ See also Sloan v. Lemon, 413 U.S. 825, 832 (1973).

4/ Nyquist specifically distinguished this Court's earlier decisions in Everson v. Board of Education, 330 U.S. 1 (1947), and Board of Education v. Allen, 392 U.S. 236 (1968), on the ground that "the class of beneficiaries [in both those cases] included all schoolchildren, those in public as well as those in private schools." 413 U.S. at 782 n.38 (emphasis in original).

Amici do not contend that a statutory exemption limited to religion is per se invalid under the establishment clause. See Corporation of Presiding Bishop v. Amos, 107 S.Ct. 2862, 2869 (1987). At the same time, "[t]he Court must not ignore the danger that an exception from a general obligation of citizenship on religious grounds may run afoul of the Establishment Clause . . . ." Wisconsin v. Yoder, 406 U.S. 205, 220-21 (1972). Accordingly, such exceptions have been permitted only if "vital . . . to the protection of values promoted by the right of free exercise." Id. at 221.

For example, the concern in Amos was that a broad application of Title VII to religious groups might burden their core associational rights. 107 S.Ct. at 2869. Here, there is no similar countervailing

interest. As previously noted, there is no free exercise right to a tax exemption. United States v. Lee, supra. Conversely, the denial of a tax subsidy that no one else is receiving has never been recognized as an unconstitutional burden on First Amendment freedoms. See Ragland, 107 S.Ct. at 1731 (Scalia, J., dissenting).

Viewed as a special subsidy for religion, the Texas statute cannot survive the familiar tripartite test of Lemon v. Kurtzman, 403 U.S. 602 (1971). Indeed, it fails each element of the test. There is no conceivable secular purpose in a law designed to encourage the promulgation of a religious message. Unlike Amos, this is not a case in which the state is acting "to alleviate significant governmental interference with the ability of religious organizations to define and carry out their

religious missions." 107 S.Ct. at 2868. Rather, this is a case in which the state is actively assisting religion in spreading its faith through subsidized publications.

In Edwards v. Aguillard, 107 S.Ct. 2573 (1987), this Court struck down the Louisiana Creationism Act because its requirement that evolution and creationism be given equal time in the classroom lacked a valid secular purpose. Here, Texas has gone beyond a requirement of mandated equality; it has given religion a preferential place in the marketplace of ideas through its differential tax scheme. If anything, the favored treatment of religion under the Texas statute conveys even a clearer message of endorsement than in Aguillard, and thus is more clearly barred by the establishment clause. See Grand

Rapids School District v. Ball, 473 U.S. 373, 389 (1985).

The Texas statute also has the undeniable effect of advancing religion by relieving religious magazines of the substantial tax burden imposed on other periodicals delivering a non-religious message.[5] At a very minimum, the establishment clause surely prohibits the government from granting a competitive advantage to religion in the marketplace of ideas.

Finally, the Texas law dangerously entangles church and state.[6] By its very

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[5] As previously noted, Texas Monthly paid nearly $150,000 in state sales tax for the eleven month period between January and December 1985. See pp.3-4, infra.

[6] The state's contention that its differential tax scheme is necessary to avoid entanglement between church and state is difficult to comprehend. Without the exemption, the state would simply treat religious publishers like all other publishers subject to the tax. Moreover, the tax in this case is easily calculated; it does not

(continued...)

terms, the tax exemption only applies to "[p]eriodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith . . . ." Even assuming that the bona fides of a religion can be determined without excessive entanglement, see United States v. Ballard, 322 U.S. 78 (1944), the inquiry into whether specific writings "promulgat[e] . . . the faith" is laden with establishment clause problems.

Echoing Madison's famous Memorial and Remonstrance Against Religious Assess-

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6/ (...continued)
require intrusive apportionment. Preventing such limited interaction between the state and religious publishers hardly demonstrates the compelling state interest necessary to sustain a content-based classification. See Widmar v. Vincent, 454 U.S. 263, 276 (1981).

ments,[7] this Court has frequently noted the danger of permitting state officials to scrutinize religious speech and determine its religious content, albeit in contexts in which the religious speech is typically the subject of censorship rather than favored treatment.

For example, in Cantwell v. Connecticut, 310 U.S. 296 (1940), the Court rejected the right of public officials to determine what is or is not a "religious

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[7] Madison objected to a proposed public tax in support of religious education on a variety of grounds, including his concern that

> the bill implies either that the Civil Magistrate is a competent Judge of Religious truth; or that he may employ Religion as an engine of Civil policy. The first is an arrogant pretension falsified by the contradictory opinions of Rulers in all ages, and throughout the world: The second an unhallowed perversion of the means of salvation.

See Everson v. Board of Education, 330 U.S. at 67.

cause." As the Court correctly observed, such judgments inevitably involve the "appraisal of facts, the exercise of judgment, and the formation of an opinion." Id. at 305. For both practical and historical reasons, the Court found such a grant of discretionary authority incompatible with the notion of religious liberty protected by the First Amendment.

Similarly, in Widmar v. Vincent, 454 U.S. 263, 269 n.6 (1981), this Court rejected a proposed distinction between religious worship and religious speech on the ground that it would compel the state

> "to inquire into the significance of words and practices to different religious faiths, and in varying circumstances to the same religious faith. Such inquiries would tend inevitably to entangle the State with religion in a manner forbidden by our cases."

Accord, Lemon v. Kurtzman, 403 U.S. at 620 ("state inspection and evaluation of the religious content of a religious organization is fraught with the sort of entanglement that the Constitution forbids"); Fowler v. Rhode Island, 345 U.S. 67, 70 (1953)("it is no business of courts to say that what is a religious practice or activity for one group is not religion under the protection of the First Amendment").[8/]

In an effort to avoid these entanglement problems, Texas officials testified at trial that "we leave it to [the organization] to decide whether or not it's a publication that teaches their faith." 731

8/ The dissenting opinion below made a similar point: "It is important for the continued ability of all people to worship as they choose that no state official be allowed to determine what is and what is not a religion." 731 S.W.2d at 166.

S.W.2d at 164. This hands-off approach, however, only creates different establishment clause problems.

Needless to say, Texas does not ordinarily allow taxpayers to determine their own eligibility for a tax exemption. By ceding that authority to religion in this instance, Texas has created a statutory framework that "enmeshes churches in the processes of government." Larkin v. Grendel's Den, Inc., 459 U.S. 116, 127 (1982). The benefit obtained by religion is therefore real and "symbolic." Id. at 125. Both on its face and as applied, the Texas statute cannot be reconciled with the establishment clause.

CONCLUSION

The First Amendment mandates government neutrality toward thought and belief. Texas has violated that mandate by enacting a special tax exemption for religious periodicals. For the reasons stated herein, the judgment below should be reversed.

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No. 87-1245

IN THE
Supreme Court of the United States
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TEXAS MONTHLY, INC.,
Appellant,

v.

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS, AND ANN RICHARDS, TREASURER OF THE STATE OF TEXAS,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF OF THE MAGAZINE PUBLISHERS OF AMERICA, INC., *AMICUS CURIAE*

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IN THE

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OCTOBER TERM, 1987

No. 87-1245

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Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* OF THE MAGAZINE PUBLISHERS OF AMERICA, INC.

Movant is a national trade association of magazine publishers who publish consumer interest magazines. The written consent of the appellant, Texas Monthly, Inc., has been obtained and filed with the clerk of this Court. The consent of the appellees has been requested and refused.

Movant seeks to submit a brief *amicus curiae* because it shares with appellant a vital interest in the outcome of this proceeding. The imposition of the Texas sales tax on ap-

pellant's and other publications, but not on certain religious publications, impermissibly abridges appellant's and other publishers' rights and involves the State of Texas in the advancement of a religious faith in violation of the First and Fourteenth Amendments to the Constitution of the United States.

Movant requests this Court to grant leave to file the accompanying brief *amicus curiae* to present its views to this Court urging reversal of the opinion of the court below.

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BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS, AND ANN RICHARDS, TREASURER OF THE STATE OF TEXAS,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS, THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

BRIEF OF THE MAGAZINE PUBLISHERS OF AMERICA, INC., *AMICUS CURIAE*

INTEREST OF THE *AMICUS CURIAE*

The Magazine Publishers of America, Inc., (MPA) is a national trade association including in its membership more than 200 magazine publishing firms that publish about 900 magazines sold at newsstands and by subscription. MPA members provide broad coverage of domestic and international news in weekly and biweekly publications, and publish weekly, biweekly and monthly publications related to literature, religion, law,

political affairs, science, agriculture, industry and many other interests, avocations, and pastimes of the American people.

MPA shares with Texas Monthly, Inc., and others a commitment to exercise and preserve First Amendment liberties protected by the Constitution and this Court. We believe that the decision of the Texas Court of Appeals upholding the constitutionality of the Texas sales tax abridges the Freedom of Speech and of the Press of all but the exempt; and, because of the exemption solely of religious publications, the statute involves the State of Texas in the advancement of a religious faith in violation of the Establishment Clause of the First Amendment.

SUMMARY OF ARGUMENT

In upholding the constitutionality of the Texas retail sales tax, which applied to all publications except publications consisting wholly of religious writing published or distributed by a religious faith, the Texas Court of Appeals misread this Court's decision in *Arkansas Writers' Project v. Ragland*, 107 S Ct 1722; 95 L Ed 2d 209. The Texas court construed *Arkansas Writers' Project* to apply only when the press in general is singled out for taxation, or when a small number of publications are taxed. That narrow reading of the case ignores this Court's specific finding that the Arkansas tax was unconstitutional because the application of the tax depended entirely on content of the publication. In that sense, the Texas statute is identical to the Arkansas statute: the applicability of the tax is determined by the content of the publication.

The Texas court failed to apply the proper standard to test the validity of statutes suspected of infringing on First Amendment rights. The Texas court applied the "rational legislative purpose" standard and put the burden of proof on appellant

to negate the reasonableness of the tax. In cases involving First Amendment rights, the proper standard imposes upon the state the burden to prove that a statute serves a compelling state interest and is narrowly drawn to achieve that purpose.

The Texas court also erred in finding that the exemption of religious publications does not violate the Establishment Clause of the First Amendment. By requiring the state to judge which publishers and publications are eligible for tax exemption, the state becomes inextricably involved in religious affairs, and by exempting religious publications from a tax applicable to all other publications, the state necessarily advances the cause of a religious faith in violation of the Establishment Clause of the First Admendment.

ARGUMENT

1. The Texas sales tax, which applies to publications based on the content of the publication, impermissibly restricts expression based on its message.

In 1985, Texas Monthly, Inc., publisher of *Texas Monthly*, sued in the district court of Travis County, Texas, for a refund of sales tax revenues collected and paid to the state in 1985 for the sale of its magazine. The district court agreed with the plaintiff that section 151.312 of the Texas Tax Code, exempting certain religious publications from the payment of sales taxes, "constitutes an unlawful discrimination based on the content of Plaintiff's publication in violation of its rights under the First and Fourteenth Amendments" of the Constitution of the United States. J.S. App. 42. On appeal, a majority of the Texas Court of Appeals reversed, holding that the statute did not discriminate in violation of the plaintiff's right of free speech, but merely protected the church and

church publications from governmental interference. Two months later, following this Court's decision in *Arkansas Writers' Project v. Ragland*, 107 S Ct 1722; 95 L Ed 2d 209, the majority withdrew its initial opinion and issued a second opinion. In that opinion, the Texas court concluded that *Arkansas Writers' Project* was not applicable to the issue before the court, saying:

> The Supreme Court determined that the tax exemption in *Ragland* was so broad that it had the effect of singling out a very small group of magazines for *taxation*. This appeal, to the contrary, presents the opposite situation. The great mass of publishers remain subject to the sales tax. The Legislature has rationally determined to *exempt* religious publications as a means of furthering the separation of church and state. Neither of the situations deemed objectionable by the Supreme Court in *Ragland* is presented in this appeal. 731 SW 2d 160, 165; J.S. App. 9.

The Texas court misread *Arkansas Writers' Project*. This Court's statement that the Arkansas tax applied to "only a few" magazines was descriptive of the tax, not dispositive of the issue of its constitutionality. Comparing the applicability of the Arkansas sales tax to the paper-and-ink tax in *Minneapolis Star & Tribune v. Minnesota Commissioner of Revenue*, 103 S Ct 1365; 75 L Ed 2d 295 (1983), this Court made clear that the Arkansas sales tax was the far more intrusive upon First Amendment rights:

> Indeed, this case involves a more disturbing use of selective taxation than Minneapolis Star, because of the basis on which Arkansas differentiates between magazines is particularly repugnant to First Amendment principles: a magazine's tax status depends en-

> tirely on its *content*. "[A]bove all else, the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subect matter, or its content." [Citations omitted] "Regulations which permit the Government to discriminate on the basis of the content of the message cannot be tolerated under the First Amendment." [Citations omitted] 95 L Ed 2d at 219-220.

The Texas sales tax fits perfectly the description of the forbidden Arkansas tax: the Texas tax applies *based on the content of the publication*. Only periodicals "published or distributed by a religious faith" that "consist wholly of writings promulgating the teaching of the faith . . . " are exempt from taxation. Texas Tax Code, § 151.312. The method selected by both legislatures, to tax publications *based on content*, is unconstitutional.

II. The Texas Court of Appeals applied the wrong judicial standards for testing the constitutionality of the sales tax statute.

The Texas Court of Appeals, citing *Carmichael v. Southern Coke and Co.*, 301 US 495 (1936) and *Madden v. Kentucky*, 309 US 83 (1940) (neither of which involved First Amendment liberties), tested the constitutionality of the Texas sales tax on the basis of whether the legislature had a "rational legislative purpose" in enacting the exemption, and imposed upon the appellant the burden "to negate every conceivable basis which might support" the tax discrimination. Those standards are not the proper standards for evaluating the constitutionality of state action where First Amendment rights are involved. As this Court made clear in *Arkansas Writers' Project:*

> Arkansas faces a heavy burden in attempting to defend its content-based approach to taxation of

> magazines. In order to justify such differential taxation, the State must show that its regulation is necessary to serve a compelling state interest and is narrowly drawn to achieve that end. [Citation omitted] 95 L Ed 2d at 221. See also *Minneapolis Star & Tribune*, at 591-592.

This doctrine of "strict scrutiny" imposes a much greater burden upon the state than that prescribed by the Texas court, and the court's failure to follow that higher standard denied Appellant's First Amendment rights.

III. The Texas statute authorizing the state to exempt religious publications from the sales tax impermissibly involves the state in religion and advances the cause of a religious faith.

The Texas Court of Appeals upheld the exemption of religious publications against *Texas Monthly's* contention that the exemption constituted a law "respecting an establishment of religion" in violation of the First Amendment. The Texas court tested the exemption against the three-part test prescribed by this Court in *Lemon v. Kurtzman*, 91 S Ct 3205; 29 L Ed 3d 745 (1971). In that case, this Court said:

> First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion, . . . finally, the statute must not foster "an excessive entanglement with religion." 219 L Ed 2d at 755.

The Texas court found that the exemption has a "secular legislative purpose", that purpose being to achieve "neutrality" of state action. J.S. App. 5. But neutrality is not achieved by granting preferences; it is achieved by ensuring impartiality. A statute that grants tax exemptions *only* to religious

publications is not neutral and no secular purpose is served. The Texas statute fails the first *Lemon* test.

The Texas statute fails the second *Lemon* test of "primary effect" because the *sole* effect of the Texas exemption is to relieve the publishers or distributors of religous publications from paying taxes. The inevitable effect of this singular exemption is to lend state assistance to advance the cause of the religions so favored.

Finally, the Texas statute fails the third *Lemon* test because the statute requires the state to determine whether the publisher is a "religious faith" and whether the publication "consist wholly of writings promulgating the teaching of the faith." Texas Tax Code, 151.312. The state's response, that it does not carefully administer the statute, J.A. 60-61, does not satisfy a challenge to the constitutionality of the law. Appellant does not complain about the behavior of employees in the Comptroller's office; appellant complains about the state's entanglement in matters of religion required by the statute. The statute demands that the state determine eligibility for exemption, a duty that requires ascertaining the validity of an applicant's claim that it is a religious faith. To make that judgment, the state must both define a religious faith and determine who qualifies for exemption; otherwise, *anyone* claiming to be a "religious faith" — the Disciples of Christ or the Devil's Disciple — could receive an exemption from taxation. Unless the Comptroller abandons his constitutional responsibility to enforce the revenue laws, he *must* determine whether the publisher is a "religious faith" and whether the publication's contents promulgate the "teaching of the faith." Excessive entanglement is inevitable, and even if the elusive goals of defining "religious faith" and identifying its teachings are achieved, the cause of the religious faith so identified is, by the exemption from taxation, impermissibly advanced by the state.

CONCLUSION

We respectfully urge this Court to reverse the decision of the Texas Court of Appeals and affirm the judgment of hte district court.

Respectfully submitted,

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Appellees.

MOTION OF AMERICAN BOOKSELLERS ASSOCIATION, INC. FOR LEAVE TO FILE A BRIEF, AS *AMICUS CURIAE*, IN SUPPORT OF APPELLANT, AND BRIEF ATTACHED.

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Appellees.

MOTION OF AMERICAN BOOKSELLERS ASSOCIATION, INC. FOR LEAVE TO FILE A BRIEF, AS *AMICUS CURIAE*, IN SUPPORT OF APPELLANT, AND BRIEF ATTACHED.

STATEMENT

The American Booksellers Association, Inc. (referred to as AMICUS) hereby respectfully moves for leave pursuant to Rule 42 of the Rules of the Supreme Court of the United States to file the attached brief amicus curiae in this case. The consent of the attorney for Appellant has been obtained and filed with the Court. The consent of the attorneys for Appellees has not been obtained.

THE AMICUS

The *amicus'* members distribute and/or sell books and periodicals and other printed materials of all types, including those which are scholarly, literary, scientific, artistic, educational and entertaining.

The American Booksellers Association, Inc. (ABA) is the only national association of booksellers in the United States. ABA has approximately 4,000 members which maintain approximately 7,000 branches located in each of the fifty States. Its members consist of private bookstores, department bookstores, university bookstores and chain bookstores that sell to the public books of general interest that account for approximately seventy (70%) percent of all sales of books by general interest bookstores.

INTEREST OF THE *AMICUS*

The interest of the *amicus* reflects their interest in the decisions of this Court involving differential taxation of First Amendment protected materials. Amicus' brief will demonstrate how the legal principles involved in this case impact upon those who produce, distribute and sell books, magazines and other printed material protected by the First Amendment.

Although the case *sub judice* involves only magazines, the statute upheld by the Court below (and similar statutes in other jurisdictions)[1] also involves content based exemption from taxes of books of a purely religious nature. The tax on books and magazines published and/or sold by *amicus* affects the total price that consumers must pay for books and magazines that do not qualify for the exemption and, consequently, affects the number of books and magazines likely to be sold.

In view of the foregoing, *amicus* seeks leave to file the attached brief.

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[1] See Appendix A for schedule of States exempting religious publications.

Respectfully submitted,

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Dated: February 17, 1988

No. 87-1245

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

BRIEF ON BEHALF OF AMERICAN BOOKSELLERS ASSOCIATION, INC. AS *AMICUS CURIAE*, IN SUPPORT OF APPELLANT.

STATEMENT

The American Booksellers Association, Inc. (referred to as *amicus*) submits this brief *amicus curiae*, pursuant to Rule 36 of the Rules of the Supreme Court of the United States, in support of the appellant Texas Monthly, Inc., having submitted a motion for permission to file same.

INTEREST OF THE *AMICUS* AND SUMMARY OF ARGUMENT

The interest of the *amicus* reflects its interest in the decisions of this Court involving content based taxation of First Amendment protected materials. Amicus' brief will demonstrate how the legal principles involved in this case impact upon those who produce, distribute and sell books, magazines and other printed material protected by the First Amendment.

Although the case *sub judice* involves only magazines, the statute upheld by the Court below (and similar statutes in other jurisdictions) also involves content based exemption from taxes of certain books of a purely religious nature. The tax on books and magazines published and sold by *amicus* affects the total price that consumers must pay for books and magazines that do not qualify for the exemption and, consequently, affects the number of books and magazines likely to be sold by *amicus*.

The Texas statute collides with the First Amendment's prohibition against content-based distinctions by government – what Harry Kalven, Jr. termed "the consensus on untouchable content."[2] " 'Regulations which permit the Government to discriminate on the basis of the content of the message cannot be tolerated under the First Amendment.' " *Arkansas Writers' Project, Inc. v. Ragland*, ___ U.S. ___, ___ 107 S.Ct. 1722, 1727-1728 (1987), quoting *Regan v. Time, Inc.* 468 U.S. 641, 648-649 104 S.Ct. 3262, 3266-3267 (1984).

Beyond question, the statute requires the State of Texas to differentiate one group of publications from the next based on their message. At its core, this is an illegitimate task for government, for it necessarily involves the favoring of one type of speech over another. Whatever the purported reason to support the distinction – and throughout history the reasons have been many and subtle – an assessment that certain speech shall receive more preferential treatment than other speech clashes with the central notion that all ideas command equal validity and shall be freely judged by the individual. As the Supreme Court wrote

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[2] *A Worthy Tradition* 6 (Jamie Kalven ed. 1988).

in *Police Dep't of Chicago v. Mosley*, "there is an 'equality of status in the field of ideas,' and government must afford all points of view an equal opportunity to be heard." 408 U.S. 92, 96, 92 S.Ct. 2286, 2290 (1972) (hereinafter "*Mosley*").

This core notion that content-based discrimination is repugnant under the First Amendment is what fueled the Supreme Court's decision in *Arkansas Writers' Project Inc., v. Ragland*, as it had in *Mosley* and many other decisions. *See, e.g., Regan v. Time, Inc. supra, Consolidated Edison Co. v. Public Service Commission of New York*, 447 U.S. 530, 100 S.Ct. 2236 (1980) (etc.). *Mosley*, like the case at bar, gave preferential treatment to one category of speech by exempting it from a regulation which had the overall effect of burdening speech. There, also, the exemption was justified by a rationale separate and apart from the content of the speech. As the Supreme Court there held, "(the government) may not select which issues are worth discussing or debating . . . " 408 U.S. at 96, 92 S.Ct. at 2290. No matter what the justification for the religious exemption here contested, the statute conveys a message that the State of Texas selects religion as a more valuable subject of public discussion than others. Although the coercive effect of the Texas law may not be as blunt as in *Mosley*, it is nonetheless present, for the statute invites publishers to mold their works to fall within the statute (and hence avoid the sales tax burden), instead of leaving to the editor decisions as to content. This channeling of content by the State is fundamentally at odds with constitutional doctrine and warrants this Court's overturning of the Texas statute.

The second and related defect in the Texas statute centers on the official scrutiny of text that must occur as the statute is applied. The very specter of government review of written material is contrary to our constitutional tradition. Moreover, the statute calls upon the judgment of some government official to determine whether the contents of a publication "consist *wholly* of writings *promulgating* the *teachings of the faith*." Texas Tax Code Section 151.312. This is far too reminiscent of the censor's iron rule over what qualifies as true faith. Take for example, two periodicals, one that applies Christian teachings on the brotherhood of man, excerpted from the New Testament, to

biblical parables, and one which applies the same excerpts to modern-day regional conflicts. The statute thrusts the State into the role of determining whether one or both of these publications promulgates the teachings of Christianity. A more inappropriate and repressive role for government cannot be imagined.[3] Content-discrimination, by definition, places the State in the role of judge, and thus usurps the right of the individual to assess ideas for himself.

The court below, invoking the Equal Protection Clause, held the tax exemption in question to be constitutional on the ground that "[t]he legislature may make rational distinctions of degree having a rational basis." (App. 3, App. 25)[4] In so doing it applied the rational basis test, citing several Texas Court decisions as well as *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 57 S.Ct. 868 (1936). That court appeared to ignore the clear mandate of *Arkansas Writer's*, *supra* at 1728, holding:

> Arkansas faces a heavy burden in attempting to defend its content based approach to taxation of magazines. In order to justify such differential taxation, the State must show that its regulation is necessary to serve a compelling State interest and is narrowly drawn to achieve that end. *See, Minneapolis Star*, 460 U.S. at 591-592, 103 S.Ct., at 1375.

The court below further justified its finding of constitutionality on the ground that the tax exemption constitutes a subsidy and that "the failure of the State to subsidize speech does not

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[3] In this manner, the statute also runs afoul of the establishment clause, as explicated in Plaintiff's Jurisdictional Statement. The two clauses of the First Amendment unite in their respect for the individual's right to his beliefs. "The freedom of speech clause of the First Amendment has been the beneficiary of the religion clauses. . . . In America there is no heresy, no blasphemy." Kalven, *supra*, *A Worthy Tradition* at 7; See also *Lemon v. Kurtzman*, 403 U.S. 602, 91 S.Ct. 2105 (1971).

[4] References to the original opinion of the court below are contained in Appellant's Appendix (App. 23-41); references to the opinion on rehearing are contained in Appellant's Appendix (App. 1-22).

significantly interfere with First Amendment rights." (App. 30, App. 9-10) (citing *Regan v. Taxation With Representation of Washington*, 461, U.S. 540, 103 S.Ct. 1997 (1983). In so doing the court below appears to be relying entirely upon the argument set forth in the dissenting opinion of Justice Scalia in *Arkansas Writer's* in its statement about "coercion":

> However, Texas Monthly has not shown that the legislature's failure to grant this benefit to other types of publications has "coerced" them into restricting their right to free speech. (App. 31-Appellant).

REASONS FOR GRANTING THE APPEAL

THE TAX EXEMPTION VIOLATES THE FIRST AMENDMENT

The Texas statute constitutes an unconstitutional violation of the First and Fourteenth Amendments by differentially exempting from tax the sale of periodicals and of books. Since the basis for such differential treatment is the religious source or the religious content of presumptively First Amendment protected material, such exemption violates both the speech and establishment clauses of the First Amendment and The Equal Protection Clause of the Fourteenth Amendment. In light of the many jurisdictions with similarly unconstitutional exemptions, the issue should be resolved by this Court.

Unless this Court is prepared to overrule *Arkansas Writer's Project, Inc. v. Ragland*, ____ U.S. ____, 107 S.Ct. 1722 (1987), and *Minneapolis Star & Tribune v. Minnesota Commissioner of Revenue*, 460 U.S. 575, 103 S.Ct. 1365 (1983), it is clear that it must apply a standard of heightened scrutiny in examining the content based approach to taxation of magazines and books found in the sales tax statute that is the subject of this appeal. *Arkansas Writer's, supra*, at 1728; *See Minneapolis Star*, 460 U.S. at 591-592, 103 S.Ct., at 1375.

The State of Texas has failed to advance any compelling state interest to justify the differential taxation of magazines and books resulting from the tax exemption at issue. Certainly the state's

general interest in raising revenues is insufficient. *Arkansas Writer's*, *supra*, at 1728; *Minneapolis Star*, *supra*, 460 U.S. at 591-592, 103 S.Ct., at 1375. The only other state interest alluded to by the court below is its interest in furthering the "secular purpose" of "restricting the fiscal relationship between church and State." (App. 3, App. 26-27). This argument is flawed in two respects:

> (1) Carried to its logical conclusion it would require that "the church" be exempt from all taxes of any kind so as to "restrict the fiscal relationship between church and State, . . . and . . . reinforce the desired separation insulating each from the other." (App. 5, App. 26-27); and
>
> (2) The statute in question is not applicable only to printed materials that are "published or distributed by a religious faith, but also to "books that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religious faith," (App. 56) even if published by secular publishers.

In any event, a discriminatory tax exemption is hardly the least intrusive method of accomplishing such a result.

Perhaps the most serious failing of the opinion of the court below was its failure to acknowledge the long-established principle that government has no power to restrict expression because of its message. Indeed, this Court made that very point in *Arkansas Writer's* when it held:

> Above all else, the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, or its content.' *Police Department of Chicago* v. *Mosley*, 408 U.S., at 95, 92 S.Ct., at 2289. *See, Also, Cary* v. *Brown*, *supra*, at 462-463, 100 S.Ct. at 2291. 'Regulations which permit government to discriminate on the basis

> of the content of the message cannot be tolerated under the First Amendment.' *Regan v. Time, Inc.*, 468 U.S. 641, 648-649, 104 S.Ct. 3262, 3266-3267 (1984).

Nevertheless, on rehearing, the court below identified a tax which "targets a small group within the press as a whole" as one of two impermissible types of taxes against the press found in *Arkansas Writer's*, (App. 9). It distinguished the tax exemption there by holding it singled out a very small group of magazines for taxation, while in the instant case "the great mass of publishers remain subject to the sales tax." (App. 9). Thus, the court below interpreted *Arkansas Writer's* as holding that the exemption from tax of a favored few publishers was constitutionally permissible while an exemption favoring a large majority of publishers is impermissible. Such an incongruous interpretation of *Arkansas Writer's* ignores the crux of that decision:

> Indeed, this case involves a more disturbing use of selective taxation than *Minneapolis Star*, because the basis on which Arkansas differentiates between magazines is particularly repugnant to First Amendment principles: a magazine's tax status depends entirely on its content. *Arkansas Writer's*, *supra* at 1727-28.

In order to determine whether a book or magazine is subject to sales tax, Texas's enforcement authorities must necessarily examine the content of the message that is conveyed. "Such official scrutiny of the content of publications as the basis for imposing a tax is entirely incompatible with the First Amendment's guarantee of freedom of the press." *Arkansas Writer's*, *supra*, at 1728; *See Regan v. Time, Inc.*, 468 U.S. 641 at 648, 104 S.Ct. 3262, at 3266.

The court below, in rejecting the applicability of the First Amendment to this issue, places heavy reliance upon *Regan v. Taxation With Representation*, *supra*. It summarizes *Regan* by stating "[i]n short, the Supreme Court held that the failure of the State to subsidize speech does not significantly interfere

with First Amendment rights." (App. 30) The opinion then attempts to show that the same logic is applicable to the issue in the instant case.

However, that same argument was apparently made and rejected in *Arkansas Writer's*. The core of the dissent of Justice Scalia, with whom Chief Justice Rehnquist joined, is that "a legislature's decision not to subsidize the exercise of a fundamental right does not infringe the right and thus is not subject to strict scrutiny." *Arkansas Writer's*, *supra*, at 1731 quoting from *Regan* v. *Taxation With Representation of Washington*, *supra*, 461 U.S. 540, 544, 549, 103 S.Ct. 1997, 2000, 2002. The majority opinions in both *Minneapolis Star*, and *Arkansas Writer's*, clearly rejecting the "subsidy" argument, held that "strict scrutiny" is the proper standard to be applied to a statute differentially exempting from tax First Amendment protected materials of the same genre.

The court below also appeared to rely heavily on the argument set forth by Justice Scalia in his *Arkansas Writer's* dissent:

> The reason that denial of participation in a tax exemption or other subsidy scheme does not necessarily 'infringe' on a fundamental right is that – unlike direct restriction or prohibition – such a denial does not, as a general rule, have a significant coercive effect. *Arkansas Writer's*, *supra*, at 1731, (Justice Scalia dissenting).

However, the "coercion" criterion conflicts with the well established principle that a government benefit may not be conditioned on a requirement that violates the beneficiary's constitutional rights. *See Speiser* v. *Randall*, 357 U.S. 513, 518-19, 78 S.Ct. 1332, 1338 (1958) (tax exemption could not be conditioned on signing of a non-communist affidavit); *Personnel Administrator of Mass.* v. *Feeney*, 442 U.S. 256, 99 S.Ct. 2282 (1979). Clearly, the possible withholding of tax exemption in *Speiser* was not coercive in the normal sense of the word. The conclusion appears inescapable, therefore, that accepting the "coercion criterion" requires the abandonment of the well established principles set forth in *Speiser* and its progeny.

THE TAX EXEMPTION VIOLATES THE EQUAL PROTECTION CLAUSE

When the Equal Protection Clause is applied to legislation affecting fundamental rights such as free speech and press, the "strict scrutiny test" is invoked. See *Massachusetts Board v. Murgia*, 424, U.S. 307, 96 S.Ct. 2562 (1976). That standard calls for a rigorous review, as summarized in *Antioch v. Candidates Outdoor Graphic Services*, 557, F. Supp. 52 (N.D. Cal. 1982).

> First, the law is presumptively unconstitutional and the State bears the burden of justification . . . Second, the law must bear a 'substantial relation' to a 'weighty' governmental interest . . . The law cannot be justified merely by the showing of some legitimate governmental interest . . . Third, the law must be the least drastic means of protecting the governmental interest involved; its restrictions may be 'no greater than necessary or essential to the protection of the governmental interest.

557 F. Supp. at 55.

There is nothing in the opinion of the court below to indicate that the State of Texas has proven such a compelling or weighty State interest. The argument that by financially assisting the church Texas has furthered the cause of separation of church and State is not only ludicrous, but flies in the face of *Lemon v. Kurtzman*, 403 U.S. 602, 91 S.Ct. 2105 (1971).

CONCLUSION

Content based tax exemptions for some, but not all magazines, or some, but not all books, are unconstitutional. Such exemptions exist under the sales tax laws of many states other than Texas. We, therefore, respectfully urge this Court to accept the appeal of Appellant, or, in the alternative, to reverse the judgment of the court below.

Respectfully submitted,

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APPENDIX

APPENDIX A

STATES THAT SPECIFICALLY EXEMPT RELIGIOUS BOOKS

Alabama – printed or illustrated lessons distributed by religious organizations without charge to pupils in Sunday schools, etc., operated by organization.

Georgia – Holy Scriptures; sales of religious papers by religious organizations.

Indiana – sales of Bibles and prayer books by religious organizations.

Maine – the Bible.

Massachusetts – books used for religious worship.

New Jersey – sacred scriptures.

North Carolina – the Bible.

North Dakota – religious material.

Pennsylvania – Bible.

South Carolina – the Bible.

Tennessee – religious publications.

Texas – Old and New Testaments, Koran, other religious works.